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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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Federal Communications Commission
Office of Secretary

In the Matter of)
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Extension Of Section 272 Obligations)
Of Southwestern Bell Telephone Co.)
In The States Of Arkansas and Missouri)

WC Docket No. 04-112

PETITION OF AT&T CORP.

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September 24, 2004

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GLOSSARY OF COMMISSION ORDERS

SHORT CITE	FULL CITE
<i>Accounting Safeguards Order</i>	First Report and Order, <i>Implementation of the Telecommunications Act of 1996: Accounting Safeguards</i> , 11 FCC Rcd. 17539 (1996)
<i>Ameritech-SBC Merger Order</i>	Memorandum Opinion And Order, <i>Applications Of Ameritech Corp., Transferor, And SBC Communications Inc., Transferee, For Consent To Transfer Control Of Corporations</i> , 14 FCC Rcd. 14712 (1999)
<i>Bell Atlantic-GTE Merger Order</i>	Memorandum Opinion And Order, <i>Application Of GTE Corp., Transferor, And Bell Atlantic Corp., Transferee, For Consent To Transfer Control</i> , 15 FCC Rcd. 14032 (2000)
<i>Bell Atlantic-NYNEX Merger Order</i>	Memorandum Opinion and Order, <i>In re NYNEX Corp., and Bell Atlantic Corp., for Consent to Transfer Control of NYNEX Corp., and its Subsidiaries</i> , 12 FCC Rcd. 19985 (1997)
<i>Interim Order</i>	Order and Notice of Proposed Rulemaking, <i>In the Matter of Unbundled Access to Network Elements, Review of the Section 251 Obligations of Incumbent Local Exchange Carriers</i> , CC Docket Nos. 04-313 & 01-338, FCC 04-179
<i>LEC Classification Order</i>	Second Report and Order, <i>Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area</i> , 12 FCC Rcd. 15756 (1997)
<i>Non-Accounting Safeguards Order</i>	First Report and Order and Further Notice of Proposed Rulemaking, <i>Implementation of Non Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended</i> , 11 FCC Rcd. 21905 (1996)
<i>Non-Dominance FNPRM</i>	Further Notice of Proposed Rulemaking proceeding in FCC WC Docket No. 02-112 and CC Docket No. 00-175, FCC 03-111 (rel. May 19, 2003)
<i>Operate Independently Order</i>	Report and Order, <i>In the Matter of Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates</i> , WC Docket No. 03-228, 19 FCC Rcd. 5102 (rel. March 17, 2004)

<i>SWBT Arkansas/Missouri Order</i>	Memorandum Opinion and Order, <i>Joint Application by SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in Arkansas and Missouri</i> , WC Docket No. 01-194, 16 FCC Rcd 20719 (2001)
<i>Triennial Review Order</i>	Memorandum Opinion and Order, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket Nos. 01-338 and 96-98, 18 FCC Rcd 16978 (2003), <i>rev'd in part and remanded in U.S. Telecom Ass'n v. FCC</i> , 359 F.3d 554 (D.C. Cir.2004) ("USTA II")
<i>UNE Remand Order</i>	Third Report and Order, <i>Implementation of the Local Competition Provisions of the Telecommunications Act of 1996</i> , 15 FCC Rcd. 3696 (1999)
<i>272 Sunset Proceeding</i>	Notice of Proposed Rulemaking, <i>Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements</i> , WC Docket No. 02-112 (rel. May 24, 2002)

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PETITION OF AT&T CORP.

AT&T Corp. ("AT&T") respectfully submits this Petition and requests that the Commission extend application of the separate affiliate and other safeguards of 47 U.S.C. § 272 to Southwestern Bell Telephone Co. ("SWBT") in Arkansas and Missouri for an additional three years.

INTRODUCTION AND SUMMARY

On November 16, 2004, Section 272 will sunset in two additional SWBT states – Arkansas and Missouri – even though SBC continues to dominate the local markets and has successfully leveraged that local market power into the interLATA markets in both states. SBC, which in 2003 reported that after only two years of section 272 authorization, it already controlled over 40% of interLATA residential long distance customers in its Missouri and Arkansas footprint, has flourished under this new regime; local competition has not. CLECs' share of the local markets, primarily non-facilities based competition, was, as of December 31, 2003, only 11% in both Arkansas and Missouri.

CLEC local market share in Arkansas and Missouri is likely to decline dramatically in light of the Court of Appeals decision in *U.S. Telecom Ass'n v. FCC*, 359 F.3d 554

(D.C. Cir. 2004) (“*USTA II*”) and the Commission’s proposed revised rules on UNE-P pricing.¹ SBC’s second section 272 biennial audit report² demonstrates that in both Arkansas and Missouri, SWBT has persistently provided its long distance rivals in Arkansas and Missouri with network access that is manifestly inferior to the access it provides to its own long distance affiliate. SBC has also used its control over bottleneck special access facilities that unaffiliated carriers must buy at wholesale to engage in price squeezes for retail frame relay and other business data services.

Accordingly, AT&T requests that the Commission exercise its authority under section 272(f) of the Communications Act, 47 U.S.C. § 272(f), and find that SWBT’s enduring local market power in Arkansas and Missouri and its record of discriminatory practices and misallocation of costs in those states require the continuation of the “crucial[ly] importan[t]”³ separate affiliate and other obligations that Congress and the Commission have recognized remain necessary in a state so long as the Bell operating company (“BOC”) retains substantial market power.⁴ To do otherwise would be an abdication of the Commission’s duty to protect competition and consumers.

¹ *Interim Order*; See Wall Street Journal, August 3, 2004 at 1, “Bells Mount Two-Way Assault on Local Market.”

² Section 272 Biennial Report for SBC Communications, Inc. (“SBC”), prepared by Ernst & Young, LLP (the “Auditor”) (December 17, 2003).

³ *SWBT Arkansas/Missouri Order* ¶ 122.

⁴ The D.C. Circuit’s decision that the Commission need not issue a reviewable decision when section 272 sunsets does not apply where, as here, a Petition to Extend has been filed. *AT&T Corp. v. FCC*, 369 F.3d 554 (D.C. Cir. 2004) (“we need not decide here whether the FCC is obligated to respond to a petition to extend the § 272 safeguards if one is filed, and, if so, what the standard of review would be”). Indeed, for the reasons set forth in AT&T’s filings in that proceeding, the Commission must issue a decision on AT&T’s Petitions to Extend.

ARGUMENT

I. CONGRESS INTENDED THAT THE SECTION 272 SAFEGUARDS BE EXTENDED BEYOND THE INITIAL THREE YEAR PERIOD IF, AS HERE, LOCAL COMPETITION IS NOT SUFFICIENTLY ROBUST TO COUNTER THE BOC'S INCENTIVE AND ABILITY TO DISCRIMINATE AND MISALLOCATE COST.

As AT&T has demonstrated in its prior Petitions seeking extension of the Section 272 safeguards in Texas, Kansas and Oklahoma,⁵ Section 272 was enacted to address the problem created by the fact that the BOCs were permitted to provide in-region long distance services under section 271 merely by *opening* their local markets. Section 272 thus reflects Congress' recognition that, even after a BOC is permitted to provide in-region interLATA service in a state, it will continue to have substantial market power in the provision of local services.⁶ Section 272 targets the core concern that the BOC will leverage this local market power both to undermine existing competition in the long-distance market and to stifle fledgling competition in those local markets. In particular, the section 272 safeguards were designed to deter and detect BOC discrimination against interLATA competitors and in favor of their own long-distance affiliates and BOC subsidization of those long-distance affiliates by recovering the affiliates' costs from local and exchange access customers.⁷

⁵ Petition of AT&T Corp., Extension Of Section 272 Obligations Of Southwestern Bell Telephone Co. In The State Of Texas, (April 10, 2003) ("AT&T's Texas Petition to Extend") and Petition of AT&T Corp., Extension Of Section 272 Obligations Of Southwestern Bell Telephone Co. In The States Of Kansas and Oklahoma (Dec. 8, 2003) ("AT&T's Kansas/Oklahoma Petition to Extend").

⁶ *Non-Accounting Safeguards Order* ¶ 9 ("In enacting section 272, Congress recognized that the local exchange market will not be fully competitive immediately upon its opening").

⁷ *Id.* SBC has claimed that fears of cost misallocation and cross-subsidization are a "relic from the past," particularly because the BOCs today operate under a "pure price cap regime." SBC 272 Sunset Comments at 13, WC Docket No. 02-112 (filed Aug. 5, 2002) ("SBC 272 Sunset Comments"). However, as AT&T has shown in detail, BOCs still retain incentives and ability to misallocate costs under price cap regulation. AT&T 272 Sunset Reply Comments, Selwyn Reply Dec. ¶¶ 30-37, WC Docket No. 02-112 (filed Aug. 26, 2002); Letter from David L. Lawson, on (continued . . .)

Because Congress could not know in advance how long it would take actual price-constraining competition to develop in a particular state after local markets were finally opened to competition – competition that would eliminate the BOC's ability and incentive to leverage anticompetitively its local network facilities – it provided that section 272 would apply for a *minimum* of 3 years after a BOC received section 271 authority.⁸ But Congress recognized the possibility that a BOC's market power might not dissipate that quickly, and it provided the Commission with authority to extend those requirements by rule or by order.⁹ And it is for precisely these reasons that the Commission concluded in its initial orders implementing section 272 in 1996 that its section 272 rules would remain in place “until facilities-based alternatives to the local exchange and exchange access services of the BOCs make those safeguards no longer necessary.”¹⁰

These concerns apply with particular force in the case of SWBT. In its *Ameritech-SBC Merger Order*, the Commission found that the combination of Ameritech and SBC *heightened* the combined entity's “incentive to discriminate” against independent long distance carriers and

(. . . continued)

behalf of AT&T, to Marlene Dortch, Secretary, Federal Communications Commission, Selwyn *Ex parte* Dec. ¶¶ 44-45, Verizon Ol&M Petition, CC Docket No. 96-149 (filed Nov. 15, 2002); AT&T's *Non-Dominance FNPRM* Comments, Selwyn Dec. ¶¶ 97-103 (filed June 30, 2003); AT&T's Reply *Non-Dominance FNPRM* Comments, Selwyn Reply Dec. ¶¶ 57-58 (filed July 28, 2003). All are incorporated herein by reference. The risk of BOC discrimination and cost misallocation is therefore, far more than a theoretical concern – it presents a real and substantial threat to the great “strength of competition in the interexchange market.” *Ameritech-SBC Merger Order* ¶ 213.

⁸ 47 U.S.C. § 272(f)(1).

⁹ *Id.*

¹⁰ *Non-Accounting Safeguards Order* ¶ 13; see also, Notice, 272 *Sunset Proceeding* WC Docket No. 02-112 ¶ 12 (the Commission could “support the sunset of [section 272] statutory requirements” only if and only when competitive “circumstances [have] *changed* in three years”) (emphasis added).

that this incentive is “particularly acute with regards to advanced or customized access services for which detection of discrimination is most difficult.”¹¹ Moreover, in that merger the Commission rejected the claim that regulators have developed proper tools to detect and prevent discrimination by SBC and its BOC subsidiaries: “With the increased network complexity, and the possibility for new types of discrimination, comes also an increased difficulty in detecting discrimination. In such a situation, past experience with the interconnection of plain vanilla, or POTS service, becomes increasingly less useful as a regulatory tool for preventing, detecting, and remedying discrimination.”¹²

II. THE SECTION 272 SAFEGUARDS REMAIN CRITICALLY IMPORTANT IN ARKANSAS AND MISSOURI.

In light of the slow pace of local competition growth in Arkansas and Missouri, the section 272 safeguards remain as necessary today as they were when SWBT was first granted section 271 authority. Until local competition in Arkansas and Missouri is far more robust, SWBT will continue to have both the incentive and ability to discriminate in favor of its long distance affiliates and to leverage its dominance into downstream markets. Although the section 272 safeguards do not eliminate this problem – nothing less than full structural separation could accomplish that – they do provide an important regulatory tool for detecting and deterring such anticompetitive conduct.

¹¹ *Ameritech-SBC Merger Order* ¶ 196; *see also id.* ¶¶ 212-35.

¹² *Id.* ¶ 220.

~~A. There Is Insufficient Local Competition In Arkansas and Missouri To Allow Section 272 Safeguards To Sunset.~~

1. There Is No Meaningful Facilities-Based Competition In Arkansas and Missouri.

As the Commission has recognized, the most relevant competition for purposes of determining whether section 272 obligations should sunset is *facilities-based* competition enabled by deploying alternative facilities.¹³ This is because the BOC's ability anticompetitively to harm rivals is based on its control of the bottleneck network facilities that are necessary for the provision of interLATA services. Thus, regardless of competitive carriers' retail "market share," so long as competitive carriers remain dependent upon BOC facilities to provide services to customers, a BOC can raise its rivals' costs and restrict its rivals' output by denying and/or delaying access to essential network inputs and by engaging in cross-subsidization and price squeezes.¹⁴ Indeed, this is true even when the competitive carrier uses its own facilities in connection with leasing, or purchasing at wholesale, BOC facilities. That is why the state commissions, including the Missouri Public Services Commission, have argued that the Commission should require a showing of fully competitive markets and alternative sources of supply before considering the removal of section 272 safeguards.¹⁵

¹³ See *Non-Accounting Safeguards Order* ¶ 13 (section 272, and associated implementing rules and policies, would apply "until *facilities-based* alternatives to the local exchange and exchange access services of the BOCs make those safeguards no longer necessary") (emphasis added).

¹⁴ See *LEC Classification Order* ¶¶ 100, 158; *Non-Accounting Safeguards Order* ¶¶ 9-13; see also *Verizon Communications, Inc. v. FCC*, 535 U.S. 467, 490-491 (2002) ("*Verizon*") (The carrier that controls the "local-loop plant" could "place conditions or fees . . . on long-distance carriers seeking to connect with its network").

¹⁵ Missouri PSC 272 Sunset Comments at 3, 4, WC Docket No. 02-112 (filed Aug. 5, 2002) ("Missouri PSC 272 Sunset Comments") (retain safeguards "until such time as the BOC no longer has an incentive and the ability to discriminate against long distance competitors or to engage in other anti-competitive conduct"); See also, Texas PUC 272 Sunset Comments at 3, WC Docket No. 02-112, (filed July 25, 2002) ("Texas PUC 272 Sunset Comments")
(continued . . .)

The record in the *Non-Dominance FNPRM* shows that in the vast majority of cases, there are no alternatives to the ILEC special access facilities that are essential inputs not only for IXCs but also for suppliers of local, wireless and broadband services.¹⁶ CLEC providers of special access are themselves critically dependent on the purchase of ILEC special access facilities.¹⁷ Even where CLEC-owned special access facilities exist, they are not fungible from one location to another and therefore cannot provide an effective constraint on ILEC price increases.¹⁸ This is true even in the largest (“enterprise”) segment of the business market – UBS Investment Research reports that: “AT&T and MCI still purchase special access services to reach more than 70-80% of their enterprise customers ... In many instances the special access circuits required to connect the end user to the IXC network represents the majority of the total cost of the circuit. That is, more than 50% of the total cost of a frame relay drop or private line is represented by the cost of the last mile that the IXCs must pay to the ILECs.”¹⁹

(... continued)

(“[P]rudence demands that the sunset period be extended *until the conditions which necessitated the creation of competitive safeguards no longer exist*”) (emphasis added); see also Washington UTC 272 Sunset Comments at 2, WC Docket No. 02-112 (filed Aug. 5, 2002) (“Washington UTC 272 Sunset Comments”) (Commission should not “lift[] the safeguards too soon,” i.e., before “robust, sustainable competition . . . develop[s]”).

¹⁶ AT&T’s Reply Comments in the *Non-Dominance FNPRM* proceeding (July 28, 2003) at 8-9. Sprint Comments (June 30, 2003) at 8 (only about 4 percent of commercial buildings are served by CLEC-provided special access facilities).

¹⁷ AT&T Comments in the *Non-Dominance FNPRM* proceeding (June 30, 2003) at 20.

¹⁸ AHTUC Comments in the *Non-Dominance FNPRM* proceeding (June 30, 2003) at 11 (“firms in truly competitive markets would not be able to raise prices and collect supracompetitive profits as the BOCs have done for special access prices without attracting competitors who would be able to take away customers by charging fully compensatory but far lower prices”).

¹⁹ UBS Investment Research, “How Access Charges Determine Winners and Losers in Telecom Services” 2 April 2004 at 22.

There are no significant facilities-based alternatives to SBC's local exchange and access services, including special access services, in Arkansas and Missouri, and, as a result, the section 272 safeguards remain necessary in those states. There is little facilities based competition,²⁰ and facilities based competitive carriers such as McLeodUSA have been pushed into bankruptcy and/or have been required to restructure financially.²¹ Competitive carriers in Missouri and Arkansas remain highly dependent upon SWBT to provide local telephone services in that state, as well as to originate and terminate long distance and broadband services that they provide.

SWBT dominates, and will continue to dominate, the in-region special access market.²² That is because self-deployment of key local network facilities is, in the vast majority of circumstances, uneconomic because of enormous entry barriers.²³ As the Supreme Court explained, "[i]t is easy to see why a company that owns a local exchange . . . would have an almost insurmountable competitive advantage not only in routing calls within the exchange, but,

²⁰ As of December 31, 2003 UNE-P and resale combined represented approximately 86% of CLEC lines in Missouri and approximately 69% of CLEC lines in Arkansas. *June 2004 FCC Local Competition Report* at Table 10.

²¹ McLeodUSA was forced into bankruptcy in 2002, and even when it emerged from bankruptcy has posted losses, most recently \$82.2 million for the second quarter of 2004, with a \$91.4 million loss recorded in the first quarter of 2004. Q2 2004 McLeodUSA, Inc. Earnings Conference Call – Final, 2004 WL 83567114; Hoover's Company Basic Records, 2004 WL 92681852.

²² Frost & Sullivan, U.S. Private Line Market, June 2004 at 15, 61 and 62.

²³ See e.g., *Triennial Review Order* ¶ 325 (record "contains little evidence of competitive CLECs' ability to self-deploy single DS1 capacity loops and scant evidence of wholesale alternatives;" CLECs "seeking to serve DS1 enterprise customers face extremely high economic and operational barriers in deploying DS1 loops to serve these customers"), ¶ 320 (CLECs impaired in their ability to deploy DS3 loops); ¶ 298; ¶ 386 (CLECs impaired without access to DS3 transport based on high fixed and sunk costs and scale economies); ¶¶ 391-92 (record "indicates that competing carriers generally cannot self-provide DS1 transport" and "DS1 transport is not generally made available on a wholesale basis").

through its control of this local market, in the market[] for long-distance calling as well.”²⁴

Moreover, SBC has discouraged the entry of competitive special access providers, or self-provisioning by IXCs, by “locking up” demand, requiring IXCs to commit virtually all of their access requirements to SBC for considerable periods of time with SBC in order to obtain discounts needed in order to compete with SBC.²⁵

Neither VoIP nor cable telephony services have emerged to date as a meaningful source of facilities-based competition in either state.²⁶ VoIP and cable telephony services have an infinitesimal fraction of the customers served by the BOCs. For example, In-Stat/MDR reports that there were just 114,000 U.S. broadband IP telephony subscribers in 2003 and forecasts that this number will increase to 4.1 million in 2007 -- which is still less than the *net increase* in BOC long distance customers in *each* of the last four quarters (2Q03-1Q04) reported by Merrill Lynch.²⁷ Indeed Verizon recently minimized the significance of VoIP competition on its local

²⁴ Verizon at 491.

²⁵ See SBC Tariff No. 73 § 38.3 (receipt of volume-based discounts conditioned on the IXC’s commitment of a very significant portion of prior demand for the entire region and for all services, and on the customer’s commitment not to use UNEs for more than a small percentage – 5 percent – of its special access demand). See also, *SBC Dispute Undermines Move Toward Local Phone Competition*, Wall Street Journal at A4, (May 6, 2004) (SBC proposal to Talk America Inc. would require Talk America to send 90% or more of its phone traffic to SBC’s network instead of using its own equipment and not enter similar agreements with rival phone networks); *Illinois Bell Tel. Co. & Sage Telecom, Inc.*, ALJ Proposed Order, No. 04-0380 (Ill. Comm. Comm’n July 1, 2004) (Sage Telecom, Inc. and SBC Illinois entered a Negotiated Local Wholesale Complete Agreement which imposed penalties if Sage failed to purchase at least 450,000 lines per month and use the Agreement to meet 95% of its local needs in order to enjoy discounts); *Federal Battle Over UNE Provisions Nears End*, Telecomm Policy Report (June 16, 2004); *SBC Seeks FCC Ruling To Exempt ‘Non-251’ Terms From State Filing Mandates*, Telecommunications Reports (May 15, 2004).

²⁶ Stratecast partners, “Cable MSO Telephony: Updated Outlook and Forecast” June 4, 2004 at 5, Figure 1.

²⁷ See In-Stat MDR, *Hear This: Broadband IP Telephony*, May 2004; Merrill Lynch, *U.S. Wireline Services*, May 7, 2004, Table 7.

monopoly – “Verizon CFO Doreen Toben also said voice-over-Internet services were a ‘niche product’ that may not live up to the considerable hype surrounding them. ‘The marketing research would suggest, and this is a quote from them, this is for the ‘single geeky guys’ who are basically OK having one phone in the house they can use this way’ ... Toben said early feedback from users of other services suggests the technology may still be too complicated for many customers.”²⁸

There is little facilities-based local access competition from wireless services. On the demand side, consumers have been very reluctant to substitute their wireline local service with wireless service.²⁹ On the supply side, wireless service providers are highly dependent on the BOCs’ local bottleneck.³⁰ In any event, Cingular, controlled by BellSouth and SBC, is a significant, supplier of wireless services in SBC’s footprint. And Cingular is now acquiring AT&T Wireless. Indeed, the Cingular retained economist, a former Deputy Assistant Attorney General for Economics in the DOJ Antitrust Division, urged approval of Cingular’s proposed merger with AT&T Wireless arguing that wireless and wireline services are *not* part of the same

²⁸ <http://www.reuters.com/newsArticle.jhtml?type=internetNews&storyID=5788517>.

²⁹ See, e.g., Jon Van, “Demand lacking for home-to-cell phone number moves” Chicago Tribune, 2003 WL 69403754, (December 12, 2003) (“Local phone companies had predicted that hundreds of thousands -- possibly even millions -- of customers would abandon wired phone service when new federal rules allowing such a switch took effect two weeks ago. But the number who actually have taken the plunge is very small, numbering in the hundreds, SBC Communications Inc. reported Tuesday”).

³⁰ AT&T Wireless Comments, *Non-Dominance FNPRM* (filed June 30, 2003) at 8 (wireless carriers are highly dependent on ILEC local bottleneck facilities to connect end users to their points of presence and to carry traffic between their switches and the cell stations where antennas establish connections to users and wireless carriers’ dependence on ILEC facilities will only increase in the future as wireless carriers expand their networks).

relevant product market: “[a]t the present time, *wireline service is sufficiently differentiated from wireless service to exclude wireline from the relevant product market.*”³¹

2. Even Considering Non-Facilities-Based Competitors, SWBT Faces Insufficient Competition In Arkansas And Missouri To Allow Section 272 To Sunset.

SWBT’s overwhelming market power in Arkansas and Missouri is clear even if one includes non-facilities-based competition. The most recent *FCC Local Competition Report* shows that total CLEC market share in Arkansas and Missouri was 11% as of the end of December 2003.³² SWBT is dominant in the local market not only for residential/small business but for larger business customers as well.³³ Thus, SBC recently told investors:

- “Now let’s take a quick look at medium business. Again, our existing relationships give us an advantage. *We have a dominant share of local voice As for results, our growth rates in medium business far exceed the market norms in important areas like frame relay and dedicated Internet access.*”³⁴
- Now let’s talk about enterprise ... [w]e have a *dominant share in local voice*, and that means that for years we’ve had a long-term relationship with many of these businesses.

³¹ Declaration of Richard Gilbert, ¶ 44 (emphasis added), Cingular and AT&T Wireless, Application for Assignments of Authorization and Transfer of Control, Mar. 18, 2004.

³² *June 2004 FCC Local Competition Report* at Table 7.

³³ Competition by resale has been consistently and significantly declining over time; UNE-P losses have also declining over time. See <http://www.sbc.com/gen/investor-relations?pid=5690>, “All Files” link, Excel sheet, Tab “Wireline Access Line,” lines 16 and 42 (resale); 18 and 44 (UNE-P).

³⁴ CCBNStreetEvents, Event Transcript, SBC Communications Analyst Meeting, November 13, 2003, 1:30PM ET, Attachment 1 hereto, at 5 (emphasis added).

In fact, 244 of the Fortune 500 are headquartered in our footprint... this is really a sweet spot for SBC and reflects our capabilities and infrastructure today.”³⁵

Indeed, CLEC local market share is likely to decline and SWBT’s market dominance increase, in light of the Court of Appeals decision in *USTA II*³⁶ and the Commission’s proposed revised rules on UNE-P pricing.³⁷ Thus AT&T, on July 29, 2004 announced that it “would no longer be competing for residential local and standalone long distance (LD) customers.”³⁸ Other competitors, including MCI,³⁹ have similarly withdrawn from both the consumer local and long distance markets because of the expected rule changes. SBC has acknowledged that it is likely to gain back local market share as a result.⁴⁰ “UBS analyst John Hodulik said if most competitors

³⁵ *Id.* at 6 (emphasis added).

³⁶ See Wall Street Journal, August 3, 2004 at A1, “Bells Mount Two-Way Assault on Local Market” (noting that “[a] recent study by market-research company TNS Telecoms, found that for the first time in five years, the Bell companies increased their share of the home market slightly during the second quarter of 2004, in large part because of special discounts. The retail promotions are happening at the same time that SBC, Verizon and others are pushing state regulators to raise the rates they can charge to rivals to access their networks”).

³⁷ See *Interim Order* ¶ 29.

³⁸ Press Release, AT&T Announces Second-Quarter 2004 Earnings, Company to Stop Investing in Traditional Consumer Services; Concentrate Efforts on Business Markets, Thursday July 22, 6:50 am ET, http://biz.yahoo.com/prnews/040722/nyth034_1.html.

³⁹ See *MCI Hires Advisers For Likely Sale Bid*, Washington Post (Sept. 21, 2004) http://news.yahoo.com/news?tmpl=story&u=/washpost/20040921/tc_washpost/a36879_2004sep20 (“Five months ago, MCI claimed it had 20 million customers. Now the company says its total customer base has shrunk to about 15 million. During the same period, Verizon Communications Inc., BellSouth Corp. and SBC Communications Inc. reported dramatic increases in long-distance subscribers ... In July, AT&T announced it would no longer compete for new residential customers and would instead focus on its business customer base. MCI has quietly taken similar steps and is no longer competing in the residential business”).

⁴⁰ On September 8, 2004 Rick Lindner, SBC Sr. VP and CFO addressed the 9th Annual Morgan Stanley Media and Communications Conference and stated that the AT&T pullback from the consumer space represents a significant opportunity for SBC. Webcast replay available at: <http://www.sbc.com/gen/investor-relations?pid=5647>. He also stated that of SBC's

(continued ...)

stop marketing by 2005, the Bells could recapture 8 million lines over the following year.”⁴¹ It was also reported that “[f]ive private investment firms who have backed small telecommunications companies told U.S. regulators ... that price hikes for leasing access to other networks could lead some to violate debt covenants”.⁴²

3. SWBT Has Leveraged its Local Market Power To Rapidly Gain Long Distance Share in Arkansas and Missouri.

SWBT, through the emergence of a bundled local and long distance market, has leveraged its local market power to rapidly gain long distance share. The last time SBC reported its long distance penetration by state (November 2003), it reported in excess of 40% share in the consumer long distance market in Missouri and Arkansas.⁴³ SBC further reported that within its footprint it had a business data services market share of 43% share for small business, 57% share for medium business, and 33% share for “Government, Education and Medical” or “GEM.”⁴⁴ SBC concluded that “[i]n fact, every quarter this year, we’ve delivered the best combined consumer and business long distance numbers of any RBOC, and our second quarter was the best

(... continued)

approximately 7 million UNE-P lines, AT&T and MCI together utilize approximately 4 million of the total and that 3.5 million of the 4 million are for consumer lines.

⁴¹ Reuters, Bells pursue AT&T customers as investors cheer, Wednesday July 28, 6:04 pm ET, http://biz.yahoo.com/rc/040728/telecoms_bells_1.html (“Z-Tel’s Smith said due to the rule changes, many Bell competitors could lose 50 percent of their lines over the next year or two”).

⁴² Reuters, Investors warn FCC on rising phone sharing rates, Friday July 23, 2:40 pm ET, http://biz.yahoo.com/rf/040723/telecoms_fcc_investors_1.html.

⁴³ http://www.shareholder.com/sbc/downloads/AnalystPres_nov03.pdf at 10. This was calculated in terms of “LD PICs as a % of Retail Voice Access Lines.”

⁴⁴ *Id.* at 19, 21 and 23.

ever by a regional Bell.”⁴⁵ SBC has become more circumspect in its statements to investors after November 2003. Nevertheless, in 2004, SBC has reported increased share in all segments of the market.⁴⁶

In short, SWBT’s local market power has not been significantly reduced, even three years after it won approval pursuant to section 271 to offer in-region, interLATA services. Indeed, SWBT’s local market power is likely to increase substantially after *USTA II* and the Commission’s proposed revised rules on UNE-P pricing. Until SWBT’s market power has dissipated, the reasons for each of the section 272 requirements remain, and no rational basis exists for finding that either the public interest or competition will be served by their elimination.

B. Because SWBT Continues To Misallocate Costs And To Discriminate Against Unaffiliated InterLATA Competitors In Arkansas and Missouri, The Section 272 Safeguards Must Be Extended.

Allowing the section 272 safeguards to “sunset” in the face of these facts would be profoundly anticompetitive and contrary to the public interest. So long as SWBT enjoys substantial local market power, it will have the ability to act on its clear incentives to discriminate and cross-subsidize in favor of its long distance operations. This is not mere speculation. It is confirmed by the second biennial section 272 audit of SWBT’s operations, and by press reports that the BOCs have used predatory price squeezes to eliminate competition in the residential consumer market.

⁴⁵ CCBNStreetEvents, Event Transcript, SBC Communications Analyst Meeting, November 13, 2003, 1:30PM ET, *supra*, at 4 (emphasis added).

⁴⁶ SBC Communications, Inc., Investor Briefing, No. 243, July 22, 2004 <http://www.sbc.com/gen/investor-relations?pid=5803> (“[o]ver the past year SBC long distance lines in service more than doubled to reach 4.6 million”).

1. The Second SBC Section 272 Audit Record in the Non-Dominance FNPRM Proceeding Shows Discrimination And Cost Misallocation

Despite serious design or reporting flaws in the second SBC section 272 audit identified by AT&T,⁴⁷ that audit showed discrimination and cost misallocation in both Arkansas and Missouri. The installation metric results were consistently worse for nonaffiliated carriers than for SBC's section 272 affiliate – Southwestern Bell Communications Services, Inc. (“SBCS”) – for almost all combinations of services in both states. Specifically, the second audit showed consistently worse installation metric results,⁴⁸ and fewer firm order confirmations (“FOCs”) within the first 24 hours,⁴⁹ for nonaffiliated carriers than for SBCS in Arkansas and Missouri for almost all combinations of service, DS0, DS1 and DS3. There was also strong and consistent evidence of discrimination in both states with respect to the repair metrics for both DS0 and DS1 service.⁵⁰

⁴⁷ Comments of AT&T Corp., Section 272(d) Biennial Audit of SBC Communications, Inc., EB Docket No. 03-199 (March 26, 2004) (“AT&T’s Comments on SBC’s First Biennial Audit Report”) at 4-7. The measurements used provide data in a manner that makes it difficult to analyze whether SBC is providing nondiscriminatory access to special access and other key inputs, as required by section 272. As explained more fully in the attached Declaration of statistician Dr. Robert Bell, there were two main problems: First, the tables for four performance measurements exclude information that must be reported under the *General Standard Procedures*. Bell Decl. ¶ 6. Second, the report omits all information that would allow accurate statistical inference (*i.e.*, testing for lack of parity). Bell Decl. ¶¶ 10-12.

⁴⁸ For Performance Measurement (“PM”) No. 1, “Time from Due Date to Circuit being Placed in Service” AT&T’s Comments, Bell Decl. ¶¶ 15-19 and Tables 1-3 and for PM No. 2, “Time from BOC Promised Due Date to Circuit being Placed in Service,” *Id.*, Bell Decl. ¶ 20 (noting that the data may have understated the discrimination against unaffiliated carriers for both of the performance measurements because of the methodology used).

⁴⁹ *Id.*, Bell Decl. ¶ 22.

⁵⁰ *Id.*, Bell Decl. ¶¶ 24 (unaffiliated carriers received consistently worse performance on the “Time to Restore, Trouble Duration” than SBCS for DS0 service in Arkansas and Missouri, and for DS1 service in Arkansas) and ¶ 25 (for “Mean Time to Clear Network Trouble,” unaffiliated carriers received poorer service than SBCS in Arkansas for both DS0 and DS1 service and unaffiliated carriers consistently received poorer service than the section 272 affiliate for DS1 service in Missouri). A finding of nondiscrimination also could not be made with respect to the

(continued . . .)

That audit also showed that SBC continued to violate the Internet posting requirement, failing to post (or posting only on the eve of the issuance of the Auditor's Report and years after the agreement was executed) critical agreements with its section 272 affiliate. The failure to post these agreements not only precluded unaffiliated carriers from subscribing to those services, but frustrated any effort by unaffiliated carriers to determine if the section 272 affiliate was the beneficiary of below cost arrangements leading to price squeezes against the section 272 affiliate's competitors.

The record in the *Non-Dominance FNPRM* proceeding demonstrates that SBC has used its monopoly power in special access to engage in price squeezes. Thus, SBC has been selling the special access component of its SBC PremierSERV Frame Relay at retail⁵¹ at rates lower than unaffiliated carriers could purchase it at wholesale, even with the most favorable discounts.⁵² The analysis assumed the most efficient BOC competitor qualifying for highest available wholesale discount.⁵³ Press reports have similarly noted predatory price squeezes implemented

(. . . continued)

PIC-related metrics because excluded from the metric was "PIC requests for lines that are PIC protected," and as shown in AT&T's prior comments, much of the discrimination arises out of the discriminatory enforcement of PIC freezes. *Id.*

⁵¹ SBC Data Product Reference & Pricing Guidebook, <http://www.sbc.com/gen/public-affairs?pid=319> Sections 5.2.4(C), National Volume Incentive Plan (VIP) Discount at p. 184; 5.2.4(I) "Runaway Frame Price Plan" at p. 189-190 (although squeeze exists even after expiration of Runaway Frame Price Plan); and Sections 6.2.1 at pp. 6-11 and 6.6.1 at p. 17.

⁵² SBC Special Access Wholesale Tariffed Rates: SWBT Tariff F.C.C. No. 73, Section 39, page 147 (DS-3 channel termination) effective November 21, 2003; SWBT Tariff F.C.C. No. 73, Section 39, page 66.0.124.1 (DS-1 channel termination) effective May 17, 2003; SWBT Tariff F.C.C. No. 73, Section 39, page 154.0.159 (mileage) effective November 21, 2003; SWBT Tariff F.C.C. No. 73, Section 39, page 173 (MUX) effective November 21, 2003; SWBT Tariff F.C.C. No. 73, Section 7.3.10(F)(28)(a) (HCTP and OPP) effective January 7, 2003; and SWBT Tariff F.C.C. No. 73, Section 38 (MVP discount) effective August 26, 2000.

⁵³ *Ex parte* letter from, Frank Simone, AT&T to Marlene Dortch, FCC, WC Docket No. 02-112, CC Docket Nos. 00-175, 01-337 and 02-33 at 7-11. The analysis assumed DS1 on DS3 HiCap,
(continued . . .)

for residential customers: "the three top Bell companies are ramping up discounts to attract customers while seeking to ratchet up the rates they charge rivals using their networks ... the bigger Bells -- SBC Communications Inc. ... BellSouth Corp. and Verizon Communications Inc. -- are trying to win consumers by slashing prices, to levels even they admit don't cover their costs."⁵⁴

This evidence demonstrates that SWBT has engaged in a disturbing and persistent pattern of discrimination and cross-subsidization aimed at harming its rivals. As shown below, elimination of the section 272 safeguards would substantially lessen the Commission's ability to detect and deter that misconduct.

2. Continuation Of The Section 272 Safeguards Is Essential

Section 272 can play a significant role in detecting whether such anticompetitive conduct is occurring.⁵⁵ For example, the requirement that the BOC maintain a separate affiliate and

(... continued)

with a 5-year term agreement with an MVP discount of 14% and assumed 100% fill. As shown therein, SBC charges the retail customer \$109 regardless of mileage; even at "zero mileage" SBC's retail access price was slightly below the wholesale rate. But wholesale customers must pay channel mileage between the Service Wire Center closest to the customer and the Service Wire Center near its LD POP and using the average industry (15 mile) mileage view, while SBC's retail price for access is \$109.00, non-affiliated IXCs must pay, using the best discount, \$143.59. As noted in the *ex parte*, similar price squeezes would be present in other SBC regions with other combinations of private line capacity.

⁵⁴ See Wall Street Journal, August 3, 2004 at 1, "Bells Mount Two-Way Assault on Local Market."

⁵⁵ As AT&T has explained, the protections of section 272 are unique and other regulatory protections, such as existing ARMIS regulations and equal access obligations, are not sufficient to detect and prevent discrimination and cost-shifting. AT&T 272 Sunset Reply Comments at 20-22; see also Washington UTC 272 Sunset Comments at 3 (section 272 safeguards "provide necessary consumer and competitive protections that cannot otherwise be obtained"). Thus it was only reported in a May 7, 2004 filing by SBC in ARMIS of its 2002 FCC Report 43-03 that SBC had misallocated millions in costs to SBC-AR and SBC-MO from their services affiliate - SBC Services. See attached letter and Excel spreadsheet, footnotes 4 for Arkansas and Missouri (Attachment 2).

~~maintain separate books and records in accordance with GAAP~~ significantly improves the ability of regulators and competitors to detect price squeezes.⁵⁶ The requirement that BOCs post summaries of their affiliate transactions gives regulators and competitors information that is relevant in determining whether a BOC affiliate is being charged an appropriate rate for the goods or services it obtains from the BOC, and how the affiliate's costs are aligned with the rates the affiliate is charging others. The requirements that the BOC maintain a separate affiliate and deal with that affiliate on an arm's length basis are essential for determining whether SWBT is discriminating against rivals. Similarly, both state regulators⁵⁷ and the Commission have stressed the importance of biennial audits to provide "*stringent* post-entry oversight" and a "*thorough and systematic* evaluation" of a BOC's treatment of competitors.⁵⁸ Indeed, the Commission has found such audits to be "critical" to local competition:

Commission guidance of the audit process is crucial to assuring that the accounting and structural safeguards are in place and functioning properly. Because of the critical nature of accounting safeguards in promoting competition in the telecommunications market and the *critical role* the biennial audit will play in ensuring that the safeguards are working, it is essential that we establish effective biennial audit rules at the outset.⁵⁹

The audits are also essential to deter cost-shifting.⁶⁰

⁵⁶ *Accounting Safeguards Order* ¶ 9.

⁵⁷ The Missouri PSC reports that "without the section 272 audit process, there is no way to detect and deter discrimination and anti-competitive behavior." Missouri PSC 272 Sunset Comments at 4; see Washington UTC 272 Sunset Comments at 3 ("maintaining a separate affiliate makes the audit process easier and provides more transparency to the transactions to be audited"); Pennsylvania PUC 272 Sunset Comments at 4, WC Docket No. 02-112 (filed July 22, 2002) ("Pennsylvania PUC 272 Sunset Comments") ("audits can produce useful information for policymakers such as the PUC").

⁵⁸ *Bell Atlantic-NYNEX Merger Order* ¶ 416 & n.1284 (emphasis added).

⁵⁹ See *Accounting Safeguards Order* ¶ 197 (emphases added).

⁶⁰ 272 Sunset Order, Martin Statement at 1. See also Texas PUC SBC Biennial Audit Comments at 9 ("The better course would be for the FCC to require compliance with the audit requirements (continued . . .)

In opposing AT&T's prior Petitions to extend the section 272 Sunset, SBC has argued that SWBT has no incentive to abuse its dominance, because "[a]ny attempt by a BOC to provide inferior service to other interexchange carriers – thereby creating inferior service for its local exchange customers – is more likely to alienate local exchange customers than win new interexchange customers."⁶¹ However, as AT&T demonstrated in those proceedings, SBC's argument is flawed for at least two reasons.⁶² First, the section 272 safeguards are designed to detect and prevent not just non-price discrimination by BOCs, but also *price* discrimination (e.g., using their above-cost access charges to price squeeze long distance rivals) which does not "alienate" BOC local customers, but which can devastate long distance competition.⁶³ Second, with regard to non-price discrimination, a BOC can advantage its long distance affiliate without resorting to degrading the access service it provides to rivals to the very low quality levels hypothesized by SBC. To the contrary, a BOC *discriminates* when it provides superior service to its long distance affiliate, even if the service it provides rivals satisfies some minimal standards. And in all events, so long as the BOC enjoys market power and competitive carriers must rely on the BOC to access customers, the BOC loses little by "alienating" customers because the BOC can ensure that *any* long distance carrier that they would use – other than the BOC's affiliate –

(... continued)

of Section 272 before considering whether to remove a BOC's Section 272 affiliate obligations.").

⁶¹ SBC Texas Section 272 Extension Petition Comments, WC Docket No. 02-112 (filed May 12, 2003) ("SBC Texas Section 272 Extension Petition Comments") at 7; Comments of SBC Communications, Inc., WC Docket No. 02-112 (filed Dec. 22, 2003) ("SBC Kansas/Oklahoma Section 272 Extension Petition Comments") at 5-6.

⁶² AT&T Texas Section 272 Extension Petition Reply Comments at 7-8. AT&T Kansas/Oklahoma Section 272 Extension Petition Reply Comments at 7-8.

⁶³ *Non-Accounting Safeguards Order* ¶ 12; *Access Reform Order* ¶¶ 280-82.

will receive inferior service. SBC further argued in those proceedings that “discrimination could only succeed in conferring market power on the BOC long distance affiliate if large numbers of customers adjusted their purchases as a result of it” and any attempt is bound to fail because the long distance carrier will be aware of it and complain to regulators.⁶⁴ However, the delay inherent in both identifying such discrimination⁶⁵ and collecting sufficient evidence to prove it⁶⁶ makes it difficult to both detect and deter such misconduct. The only effective alternative to structural separation is the substantially more onerous “burdensome regulatory involvement” that the Commission has expressly eschewed.⁶⁷

III. THE BENEFITS OF EXTENDING THE SECTION 272 SAFEGUARDS CLEARLY OUTWEIGH ANY COSTS THAT THEY MAY IMPOSE.

Neither SWBT nor any other BOC has ever demonstrated that compliance with the section 272 safeguards (other than perhaps the OI&M safeguard) is particularly costly, much less that those costs outweigh the clear public interest benefits of maintaining the safeguards. To the contrary, SWBT has been able to compete in – and in some cases dominate – the long distance markets without the slightest competitive handicap imposed by the section 272 safeguards.

The BOCs’ claims that section 272 safeguards prevent them from taking advantage of important economies of integration are particularly disingenuous. The Commission’s orders

⁶⁴ SBC Kansas/Oklahoma Section 272 Extension Petition Comments at 6, n. 9.

⁶⁵ The discriminatory conduct would have to go on for a sufficient period of time so that it becomes apparent to end-users. Even then, a sufficient number of end users would have to complain to the carrier before it became apparent to the carriers as well.

⁶⁶ End users are reluctant to provide such evidence since to do so alienates the BOC -- the party from whom the end users must now receive the service because of the BOC’s discriminatory conduct.

⁶⁷ *Third Order on Reconsideration* 14 FCC Rcd 16299 (1999) ¶ 20 (citing *Non-Accounting Safeguards Order* ¶ 163).

implementing section 272, most recently in the *Operate Independently* proceeding, which eliminated the Ol&M safeguard,⁶⁸ already have provided numerous opportunities for the BOCs and their section 272 affiliates to share services and take advantage of other economies.⁶⁹ Even though these joint activities present risks of anticompetitive behavior, and could easily have been prohibited entirely, the Commission permitted such activities, which substantially reduced the BOCs' costs of compliance with section 272.⁷⁰

The Commission's orders approving the SBC/Ameritech and Bell Atlantic/GTE mergers with separate affiliate conditions found that the separate affiliate requirement was an effective way to "ensure a level playing field" between a BOC and its rivals.⁷¹ These orders therefore reflect the Commission's determination that separate affiliate structures can be a cost-effective method for preventing discrimination and otherwise policing BOC misconduct. As discussed above, section 272, when properly implemented and vigorously enforced, provides substantial and unique benefits that promote competition in telecommunications markets. As state regulators have explained, if section 272 safeguards are eliminated, they "will lose a valuable

⁶⁸ *Operate Independently Order*.

⁶⁹ See, e.g., WorldCom 272 Sunset Comments at 7-9, WC Docket No. 02-112 (filed Aug. 5, 2002) ("WorldCom 272 Sunset Comments"); Time Warner 272 Sunset Comments at 17-20, WC Docket No. 02-112 (filed Aug. 5, 2002) ("Time Warner 272 Sunset Comments").

⁷⁰ The Commission has also largely eliminated restrictions on bundling, even for dominant carriers like Verizon. See *generally Bundling Order*. Thus, SBC and the other BOCs today offer customers a broad array of bundled offerings, including combinations of local, long distance, data and wireless. See e.g., http://www01.sbc.com/Products_Services/Residential/1,616--6-3-1,00.html (SBC's bundled offering); AT&T's Non-Dominance FNPRM Comments (filed June 30, 2003), Selwyn Dec. ¶¶ 39-40, 45-49, 71, 84-86.

⁷¹ *Ameritech-SBC Merger Order* ¶ 363; see *Bell Atlantic-GTE Merger Order* ¶ 260 ("strict compliance" with a "separate affiliate condition will mitigate the substantial risk of discrimination").

~~means to ensure [the BOC's] compliance with its obligations to provide access to the local exchange and exchange access markets that [the BOC] controls."~~⁷²

Eliminating section 272 requirements would also be contrary to Congress' clear purpose in enacting section 272. Given that most of the rules that the BOCs have cited as obviating the need for section 272 were in effect in 1996, Congress necessarily believed that additional protections were necessary because existing rules would not be effective in policing the BOCs' misconduct and eliminating discrimination and cost misallocation.

Whatever "burdens" that section 272 imposes on SWBT, one thing is clear: existing section 272 obligations did not prevent SWBT from quickly becoming the dominant long distance provider in its local territories. Indeed, experience with SWBT only confirms the need to strengthen, rather than abandon, existing protections against discrimination and cross-subsidization. In the absence of section 272 safeguards, SWBT would have even greater ability to exclude competitors and raise their costs.

⁷² Texas PUC 272 Sunset Comments at 3; *see also* Pennsylvania PUC 272 Sunset Comments at 5; Missouri PSC 272 Sunset Comments at 3, 4; Washington UTC 272 Sunset Comments at 2.

CONCLUSION

For the foregoing reasons, the Commission should issue a rule extending application of section 272 to SWBT in Arkansas and Missouri for an additional three years.

Respectfully submitted,

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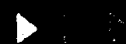
Counsel for AT&T Corp.

September 24, 2004

ATTACHMENT 1

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CCBNStreetEvents



Event Transcript

SBC - SBC Communications Analyst Meeting

Event Date/Time: Nov. 13. 2003 / 1:30PM ET

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SBC - SBC Communications Analyst Meeting

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PRESENTATION

Mike Coffee - *Managing Director of Investor Relations - SBC Communications Inc.*

Good afternoon, everyone. I'm Mike Coffey (ph), Managing Director of Investor Relations for SBC. On behalf of our management team and everybody at SBC, welcome. It's great to see such a good turnout today. I'm delighted all of you could attend.

We have a very fast-paced agenda this afternoon with presentations focused on our execution and the key opportunity areas ahead for SBC. And of course at the end, we'll have time for your questions.

Before we get started, let me cover a couple of items. First, we have support people here in the room as well as back there in the lobby. If you need assistance with anything - phones, messages, et cetera, please ask and we'll be happy to help you out.

Second, let me cover our Safe Harbor statement. Information set forth in this presentation contains financial estimates and other forward-looking statements that are subject to risks and uncertainties. A discussion of factors that may affect future results are available with the Securities and Exchange Commission in SBC's filings. SBC disclaims any obligation to update and revise

statements included in this presentation based on new information or otherwise.

At this point, it's my pleasure and my honor to turn the podium over to SBC's Chairman and Chief Executive Officer, Ed Whitacre. Ed?

Edward Whitacre - *Chairman and CEO - SBC Communications Inc.*

Thanks, Mike (ph), and good afternoon, everyone and thanks for coming today. We really appreciate it, and we appreciate your interest in our company.

I think most of you got an umbrella from SBC. My advice is don't open it because it's probably going to collapse, right? That's a subdued and late laugh.

We do have a lot of good information to cover today with you and we do have two hours to do it in, so let's get right to business. For the first time in a long time, the light at the end of the tunnel is looking to SBC more like daylight than an oncoming train. That's the best analogy we could see is an oncoming train. We obviously have some challenges, but we do have a lot of pieces of our business coming together. We're executing well and we have substantial opportunities ahead of us including opportunities on the cost side. The executives with us today will tell that story, and they will tell it in a convincing manner. It is a good story.

Ray Wilkins, who heads up Marketing and Sales, is going to cover our revenue initiatives and the consumer and business markets including the progress we're making in the enterprise space. Ray, stand up and let everybody see who you are. John Atterbury heads up our Wireline Operations - he's going to update you on cost and service initiatives. And Stan Sigman who heads up Cingular Wireless is going to cover the outstanding progress we've made in wireless this year, and he's going to give you a look at Cingular's game plan going forward.

We also have our other top management folks here today, and I'd like to introduce them and let them briefly stand so you can visit with them if you have an opportunity. The President of SBC, Bill Daley; our Chief Financial Officer, Randall Stephenson; Jim Ellis, our General Counsel; John Stankey, our Chief Information Officer who heads up our IT Operations; Karen Jennings, who's in charge of Corporate Communications and Human Resources; Forrest Miller, who runs Corporate Planning; and Mike Viola (ph), the Treasurer of SBC. All

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of us will be available if you want to talk at the end of the meeting.

I think it's important to consider that tunnel I just mentioned. The last two or three years have been the most challenging years in our company's history. As you certainly know, competition has increased dramatically, and that's put a lot of pressure on our margins. Our long-distance arm was tied behind our back, and that certainly hurt our ability to compete. We have some regulatory policies that have really rocked the industry because of lack of clarity or slowness or just plain old irrational. The soft economy has hurt demand across the board for SBC. And we've had to deal with increased pension and medical cost, and they put a lot of pressure on earnings.

Well, if that was the tunnel, I said there's some daylight ahead. And here's the daylight we see. We just launched long distance in our last five states, and that covers nearly 20 million access lines. It's a key element - long distance is - in improving our access line trends as the results in our other states show. Completing our long distance approvals also opens the doors for us to expand in the enterprise space and we're making good progress on that front, and there's more to come on that front. Cingular Wireless just turned in its best net add quarter in more than two years, and they are ahead on conversions of the network. We're also on track with our DISH alliance. It should give our customer bundle another big boost, and we're going to be ready to launch in the first quarter of 2004.

So with that information as a backdrop, I'd like to make just a few basic points. First, SBC does have a clear and focused strategy, and that strategy is working. We've built a market strategy based on bundling, and it is generating positive results. We've aggressively ramped up growth in long distance and DSL, and those are key components in the bundle. We've made a commitment to do more in terms of wireline/wireless integration. And we're determined to develop a truly integrated video component at SBC for our customers. To drive growth in bundles and strengthen our competitive position long-term, we said we needed to be more aggressive on pricing. At the same time, we took steps to move Cingular to a strong, sustainable growth track.

What you've seen in our results is that we've made good progress in every one of these areas every quarter this year. We lead the growth - we lead the group in growth of long distance. More than five million lines added in the first three quarters this year. We lead the group in DSL growth. In our long distance states, our access line results have improved dramatically with three straight quarters of significant improvement. Bundled penetration

with our key products has doubled this year. Whatever measure you want to look at - growth, momentum, network, spectrum, competitive profile, Cingular is in a much stronger position than it was at the beginning of this year. And our sequential revenue growth has improved three quarters in a row.

The second point I want to make is that SBC's execution level is very high, and we certainly intend to keep it there. In DSL, we have now delivered seven straight quarters of accelerated growth. Every long distance quarter we've delivered this year has been the best of any RBOC. At Cingular, we've delivered three straight quarters with substantial improvement in high-quality net adds. And where we have long distance, we've moved the needle on access lines three quarters in a row.

Third, I want to emphasize that we have substantial areas of opportunity ahead of us. At the top of that list is the Midwest long distance. We launched in Michigan, our first Midwest state, about six weeks ago. And I'm pleased to report that LD sales in Michigan are ahead of what we achieved over the same early weeks in California. Initial access line results over this period are also on track with our early results in California. We launched our last four Midwest states about three weeks ago. Initial sales are extremely positive there, as well.

So, as an early status report, initial results following our LD launches in the Midwest are encouraging. I expect to have good news when we report results in January, and I'm confident we can look forward to solid progress in the Midwest over the next several quarters.

In addition to our mass market opportunity, long distance coverage completion also opens the door for us in terms of national data and enterprise business, and we are making a lot of progress in this area. Our IP backbone and our outer-region networks are up and running. We've built a national sales organization, and they've already completed a number of major contracts. And we have a host of internal initiatives underway to add products and customer-care capabilities to support growth in this high-end market.

We also have big opportunities in broadband. We're really just getting started in this business, and we will expand our broadband footprint to about 80% coverage in the first quarter. We're on track to launch our SBC DISH video service in the first quarter, and that certainly is going to further strengthen our bundle. Cingular Wireless is ahead of schedule on their GSM conversion, and they've taken the initiative to significantly improve their spectrum position. Both moves have built a solid foundation for sustained growth.

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So I would like to stress that we have a lot of opportunity at SBC in long distance, DSL, DISH, Cingular, and in the enterprise market, and we are moving forward in all these areas.

Let me add an important point. We also have substantial opportunity on the cost side of our business, and we have a number of initiatives underway to change our cost structure while further enhancing customer service. We have a good, solid record on cost management. Last year, operating expenses in our wireline businesses were down more than \$1.2 billion. And through the first three quarters of this year, our wireline expenses are down again. And that's in the face of marketing initiatives and a huge hurdle from pension and retiree benefit accounting changes.

We have a number of cost projects underway throughout our operations that can have a major impact on SBC long-term. You can expect our focus and our execution on the cost side to be every bit as intense as it is on the revenue side.

The final point I'd like to make is that while we execute the key initiatives that will shape our future, our cash flow is solid and we're committed to returning value to our owners. We have taken cost out of the business. Our debt ratio is the best in the group. Since the last - since the start of last year - excuse me - since the start of last year, we've cut net debt or debt net of cash - excuse me - nearly in half to just over \$13 billion. And this year, we have returned more value to shareowners through dividends. We had a five-cent increase in the regular dividend. On top of that, over the past three quarters, we've declared 25 more cents in additional dividends. Our cash flow provides ample room, and next month our Board will evaluate our policy of returning value to the shareowners including the share repurchase program and the dividend.

So if you'll let me sum it up, I am more optimistic about the environment we're in than I've been in a long time, and I'm more confident in our ability to execute on behalf of our owners.

With that, let me turn it over to Ray Wilkins, our Group President for Marketing and Sales. I think you will be impressed with what he has to say. Ray?

Rayford Wilkins - Group President - Marketing and Sales - SBC Communications Inc.

Thank you, Ed. Good afternoon, everyone.

As Ed pointed out earlier, at SBC we're executing a clear and focused strategy - one that really focuses on customer relationships - keeping them, regaining them, and expanding them. Inherent in this strategy is positioning SBC for the future by placing emphasis on our growth products from broadband to IP products to long-distance data, wireless, Wi-Fi, and entertainment. And whether it's consumer or business, it's all about creating opportunities for relationships. And I'll expand on that as we go through.

To begin our strategy overview, let's take a quick look at the sequential trends of our wireline revenue streams. Our retail revenue stream is evenly distributed between consumer and business, which represents 74% of our total wireline revenues. Wholesale represents about 26% of the total.

Looking at the last 12 months, we've placed a lot of emphasis on improving our revenue streams. And when we look at the sequential revenue this year, we see significant improvement in consumer and more importantly in business. This has driven positive growth for two of the last three quarters. During the same period, our wholesale revenues have remained basically flat. This really shows that our overall strategies are beginning to drive the right type of momentum, which allows us to begin to grow revenues in the future.

I'm going to start today by reviewing our consumer strategies, and then we're going to spend more time on the business marketplace where there are huge opportunity for us and where we're going to be very successful going forward.

As you know, we've experienced a highly competitive environment over the past few years. In analyzing this environment, we found that 72% of our customers who left us were doing so for what they believed was a better offer. Therefore, we really needed to execute a strategy that gave us a better position in the marketplace. We knew we had to capture the customer's attention with compelling offers that really put us on par with the competition.

This approach really reflects a conscious decision to reduce prices today in order to retain our customers, and then build on those relationships over their in-service life by implementing a bundling strategy that positions us for the future rather than just for today. At the same time, we increased our advertising and developed expanded sales channels. All the while, we also focused on delivering superior service to our customers.

Our results are proving right on track and particularly with access lines and our growth (ph) products. And as a result, we're

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seeing steadily and steady improvement in our revenue streams. In the two regions where we've had long distance, we're seeing significant improvement as a result of our overall strategy. Access line losses have improved for three straight quarters, and from the second to the third quarter, our consumer line losses were 32% lower in the Southwest and 39% lower in the West where we've been in long distance for only nine months.

This gives us a lot of optimism as we look to the Midwest. The Midwest represented 64% of all of our wireline access line loss in the third quarter largely because we couldn't offer long distance as part of our bundle. Consistent with the reduction in retail access line losses has been a significant reduction in resale and UNEP lines in the West and Southwest. In fact, Southwest has been negative on UNEP growth for two consecutive quarters.

During the same period, our trends in the Midwest have remained basically the same; however, as I'm going to point out in just a minute, it represents a key opportunity as we really enter long distance here. But first let's take a look at how we're doing in consumer long distance.

We've added 4.1 million consumer lines in the first three quarters of 2003 compared to 900,000 in all of 2002. In fact, every quarter this year, we've delivered the best combined consumer and business long distance numbers of any RBOC, and our second quarter was the best ever by a regional Bell.

As you look at our penetration rates, we've achieved 32% in the consumer market in California in just nine months and 54% in Southwest in just over three years. We believe that that same kind of success can be repeated and even surpassed in the Midwest. Here's a look at the LD adoption rates in the five Southwest states and in California. And as you see, we do extremely well in the first few months after launch. And we're not slowing down right now on the adoption rates in any of our states.

Our trends continue to be very strong, and we're seeing very good upward momentum across the board. That's why we're being very aggressive in our Midwest launch, and I'm pleased to tell you, as Ed pointed out earlier, that in Michigan where we've been selling long distance since September 21, we're off to a faster start than California or any of our Southwest states. The future is looking really, really bright there.

Our success in long distance has also driven increased average revenue per user. In fact, in our long distance regions, we've increased ARPU by 6.2%. And the Midwest really has remained

flat. As we enter long distance in the Midwest, we have a tremendous opportunity to increase ARPU and to win back the customers we've lost. Here's the opportunity we see.

If we reduce the current 22% UNEP number in the Midwest to 13% where we currently are in our other regions, we have an opportunity to generate \$550-\$650 million in incremental revenue as a result of increased access line win-back and increased ARPU. Our job now is to execute on that strategy, and as I said earlier, we're doing just that in the Midwest.

Another key position for SBC is to become the broadband leader. As you know, we've put a lot of emphasis on becoming the country's broadband leader. And while we are clearly the largest DSL provider, we believe that within our footprint, we are at parity with cable modem. Our numbers tell the story. We've had seven consecutive quarters of accelerated growth resulting in 10% penetration of locations passed (ph) overall, and California is at 13% penetration. And we're continuing to increase availability, moving to 80% of homes and businesses broadband capable by the first quarter of 2004.

But there's more to the story because broadband has multiple impacts. First, DSL is highly retentive. It lowers access line churn and increases ARPU. It positions us to compete in voice-over IP as that technology develops, and it gives us the opportunity to leverage our relationship with Yahoo! to drive increased ARPU through premium services like gaming and personal communication portals.

At the same time, our approach positions us to continue to broaden our relationships with our customers while meeting their technology needs of today and positioning ourselves for the future. Today our users typically get download speeds of about 1.5 megabits per second, which accommodates almost all of the download speeds of current applications and servers.

But we also have the ability to offer four to six megabits to about 50% of the locations passed (ph) today. The bottom line is that we have the ability to meet future requirements for applications at increased speed when the need arises. So let's look at how we bring all of this together.

The key, of course, to our strategy is to bundle. And we adopted the mantra, "Nobody beats our bundles." These charts tell the story - 68% of all of our customers held some form of a bundle. At the same time, we've increased the percentage of customers who haven't bundled that include a key growth driver such as DSL or long distance from 19% in the fourth quarter of 2002 to 36% in the third quarter of this year. These bundles also

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include Cingular Wireless, and as Stan Sigman is going to point out a little bit later, it's a key differentiator, and we are now one of Cingular's largest channels. In fact, we're secondly - second only to Cingular stores.

But we're not through yet. Our next step is to add entertainment. Our plan is to integrate video in the first quarter of 2004 as we add SBC DISH. Our agreement gives us pricing flexibility, and more importantly, we'll manage the customer relationship. We'll also gain additional market advantage by enabling interactivity through a joint DSL video set-top box.

Let me quickly update you on our progress. We've set the price, our sales plans are in place, billing and ordering requirements are complete, projects with due dates over the next 60-90 days are on schedule, and we're set to launch in the first quarter of next year.

Finally, one question I always get asked about bundles is, "Does it really pay off?" Well, the answer is, "Absolutely." As you add additional products to the bundle, the impact on retention is enormous. Long distance alone reduces the rate of churn by 9%, DSL lowers the churn by 61%, and put the two together and you've cut churn by 73%.

This is the future of telecom. And we believe that we're positioned with the broadest portfolio in the marketplace, and we've planned to be a significant player in the future. Let me wrap up the consumer initiatives by reminding you that our approach really reflects a conscious decision to take some margin concession today in order to retain our customers and then build on those relationships over their in-service life.

Now let's take a look at business. The business marketplace really represents a key opportunity to SBC for a variety of reasons. First, the total opportunity here is \$140 billion of which our share is only about 10%. But our current market share has been greatly influenced by our inability to fully compete due to regulatory restrictions. Now that we are no longer constrained, our strategy is to compete aggressively in every business segment.

So let's look at how we plan to execute on this strategy. First, small business - small business is an \$11 billion opportunity, and we currently have about 32% market share. I've broken that revenue down by product, and as you can see, the biggest opportunities are in wireless and long distance. But I really believe the most significant item on this chart is our 68% market share of local voice because it really points to existing customer relationships which is a tremendous market advantage for us as we go after long distance voice and data.

Our strategy is to build on existing relationships by offering a wide variety of services and products that can easily be customized into bundles according to the customers' needs. We've tailored many of our products to small business like our new Yahoo! Business Edition Portal and Business Unlimited which provides unlimited local and LD calling for under \$60 a month. We also provide integrated access service which allows small and medium business customers to put all of their services on a converged network. And we're stimulating the market with ads really directed at small businesses to ensure they understand that we have the best offers in the marketplace.

We're also expanding our sales coverage by assigning sales reps to more than half-a-million small business customers, giving us more frequent contact and giving them a single inroad into SBC for all of their needs. And that includes face-to-face consultative sales if appropriate. The result of all of this is a 50% increase in long distance penetration rates from the first quarter of this year to the third quarter. DSL sales have climbed every single quarter and win-back rates in the small business segment have increased from 44% in the first quarter to 57% in the third quarter.

Now let's take a quick look at medium business. Again, our existing relationships give us an advantage. We have a dominant share of local voice, but the upside in long distance, wireless, and in the medium business market particularly, managed services. We're doing a lot of capture that opportunity. Our approach here is a three-pronged approach. First, compelling offers on strategically significant products, which give us a strong foothold with the customer, and then we add advanced services that give us a point of differentiation.

Finally, we are matching our portfolio with increased sales coverage. We're using comprehensive customer segmentation studies to approach each customer with recommendations specific to their industry. As for results, our growth rates in medium business far exceed the market norms in important areas like frame relay and dedicated Internet access. And our orders on managed services are up 21% from the first quarter to the third quarter of this year.

Now let's take a quick look at several key vertical markets. The key vertical markets for SBC are government, education, and medical because they are basically regional in nature. These segments have a tendency to outsource to equipment manufacturers and systems integrators for their network integration and CPE (ph) needs. However, we see this as a key growth opportunity for SBC especially as we aggressively go after managed services because of our existing local voice relationships.

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Our strategy here is to deliver customized and specialized solutions, many of which are driven by current events such as the need for improved security due to the threats on their network. One example of our recent success in the GEM space is a \$210 million six-year contract that we signed with the State of Michigan to manage all of the State's telecommunications network. And earlier this year, we were recognized by the industry analysts, Frost & Sullivan, for our innovative solutions to healthcare issues.

Now let's talk about enterprise. The fact is, when it comes to opportunity, large business is the most exciting segment to SBC. Here you see our end-of-the-year share for several key service areas compared with the total U.S. market. We have a dominant share in local voice, and that means that for years we've had a long-term relationship with many of these businesses. In fact, 244 of the Fortune 500 are headquartered in our footprint.

We have strong local relationships, and we really know how to treat the nation's top-tier companies. Our inability to offer long distance has really prevented us from serving these customers beyond their local needs. But with the regulatory relief and the capabilities that we've built in recent years, we can now grow these relationships and pursue additional enterprise business.

Now let's take a quick look at the portion of this business that we're really going after. We believe the \$34 billion opportunity on this slide is a realistic target for SBC to pursue. It represents the opportunity with only those companies that have a majority of their locations within our footprint or within the 30 cities where we are implementing our out-of-region strategy.

Now that's not to say that we won't be pursuing other opportunities. But it does say that this is really a sweet spot for SBC and reflects our capabilities and infrastructure today. Because of the many existing relationships we have with large businesses, we understand what drives their telecom spending decisions. First, they're doing more with less, so there is the profitability driver. Next, they have to be prepared for the worse, so business continuity, disaster recovery, and security are key drivers. And finally, improving communication capabilities with partners, suppliers, and customers - the relationship driver is huge.

At the same time, there are important industry trends that are driving the marketplace. One of the most significant is conversions. When you talk to CIOs of major companies today, one of the first things they mention would be IP services and their need to really converge their voice and data networks. Convergence is ideal for several reasons, primarily because it

allows enterprise businesses to put their long distance voice on a data network and reduce their overall cost. SBC is in a great position because we have every incentive to help customers make the leap. And what's more, we're once again expanding on existing relationships.

Other trends in the market include an ever-increasing need for bandwidth, new and efficient tools, and the need for quality and reliability. At the same time, resources are stretched, both human and capital resources, so these companies are looking to minimize upfront costs and are increasingly turning to compa like SBC to deliver advanced services on a management basis. The good news is, managed services really fits one of our key stresses: the experience and expertise of our people. We have the most talented and prudential team of professionals anywhere. We have 4,300 holding advance data certification. We also have industry leading partners like Cisco, IBM, EDS, and HP and we support all of this with the industry's most accomplished and respected applied research organization, SBC Labs. At the same time, we've also expanded our global accounts org from 400 to 2,000 accounts. We've added sales people and support personnel to deliver the level of service enterprise customers require, but we don't stop there. We have in place today, a powerful data and IT backbone that work to connect our in-region to our out-of-region facility. Our ATM and frame-relay backbone and our Layer-3 IT network are now operational and they are carrying customer traffic as we speak. We have a national presence.

Now let's take a look at what we're delivering over those networks. Here's a quick look at our portfolio. Keep in mind that from a service delivery standpoint, we believe that long-distance is really the easiest part. The tough part is providing powerful and reliable service at the local level, and that's been our stress for a number of years. Our transport options go from DS1 all the way to multi-service optical networks on line (ph) which can scale up to 160 gigabits/second and more. And we now provide any and all of our services on a managed basis.

Here's a short list of what we provide today. I will emphasize that we're delivering a wide range of IP service options, including the hosted IP communications services that's on demonstration outside. We have powerful, reliable webhosting solutions. We have off-site storage area networks, and we can deliver almost any service through our state-of-the-art internet data centers. Also, this portfolio stacks up well with anyone in the industry today. Our final area focus as we evolve to the best, to serve enterprise customers, is to make it easier for customers to do business with us. As you know, enterprise customers

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absolutely require things like billing flexibility, single contracts, customer service, and a single-minimum annual revenue commitment. They won't outsource a single piece of their business to a company that can't deliver all the things you see here. And SBC can deliver them all. And we deliver them today. The bottom line in enterprise is, we have what it takes and we're here to stay.

Let me wrap up with a couple of recent examples of how we're delivering national products, including voice and data services in and out of region, to customers with national needs today. These examples include major financial, industrial, and retail companies. First, we recently closed a \$350 million, 5 year contract for a nationwide frame-relay network that encompasses 4,000 sites and 11,000 routers. Another example: a \$9 million, 3 year contract, with a company headquartered out-of-region but with a significant presence in-region. It requires a 580 site frame relay network. Two more: a \$10 million, 3 year contract with a company with 6 locations in 6 states, 5 of those states though are out of our region. The contract includes a 221 sites frame-relay network plus we consolidated 100 individual agreements into a single contract. And finally, we closed a \$10 million contract which includes a 104 site frame-relay network with V S 3 (ph) connectivity. In addition, we signed w/ this company a separate \$18 mil contract for voice services. As I said, we're moving aggressively up-market, and you can expect to see more successes like these in the months ahead.

I know we're about out of time, but I want to summarize by reminding you that in consumer, our strategy is the right one. It's customer value and relationships that deliver increased long-term revenue. We have momentum and it will continue.

In business, we have up-side opportunity in every business segment. And we're leveraging our existing relationships and recent regulatory freedoms to win in all segments, particularly up-market. And we intend to be a major player in every business segment for a long time to come. SBC's future is very bright, no one's momentum is stronger and in the coming quarters and years, you're going to see the momentum that we talked about today translate into growing revenue and earning.

Now I'd like to introduce John Atterbury, who will discuss our key cost initiatives and some of the great things that we're doing to better serve our customers. So John?

John Atterbury III - Group President -- Operations - SBC

Thank you, Ray. Good afternoon. I'd like to spend the next few minutes talking about how SBC is delivering great service to our customers and at the same time, reducing our cost. You just heard Ray cover all the exciting initiatives we have on the ready in our sales and marketing groups. Once Ray's group sells a product, it's up to the wide line (ph) organization to deliver them. And we take that job very seriously because exceeding our customer expectations is key to retention and growth. And we're doing very well. We have solid customer service metrics that continue to get even better.

Today, we consistently meet or exceed our due date commitments for new voice-line installations and our repair times are declining, and that's a good thing. The same holds true for our installations only data site. Our big data pipes are virtually always installed on time, and the rare cases when these lines are down, we cut our repair intervals by 30%. DSL is another area where we make really significant progress. Now, virtually all of our customers are getting their DSL installed on time, in five business days, down from ten business days in 2001. And that's especially strong when you realize that daily, order volumes have doubled over the same time period and our repair times have been cut in half.

While our internal metrics are strong, what really matters of course is what the customer thinks. The top line on this chart in blue shows the grades they give us continue to trend upward, and we plan on maintaining that momentum. Along with a cost initiative that I will talk about later, we've launched an important company wide service initiative to make our service even better. It covers everything from service rep training, to important billing enhancements to better communication on no fieldwork orders.

The really good news here is we are improving service and productivity at the same time. For example, the orange line shows the average number of successful jobs completed by our field technicians in an 8 hour shift. You can see that we have steady progress. Now that's a brief look at our service, let me just re-emphasize that we are focused on delivering excellent customer service. We've invested time, talent, and sufficient resources in taking care of our customers. That's our heritage, that's our commitment, and it continues today.

Now let's talk about cost. Since most of our costs are in the wide line (ph) business, that's where we focused most of our energies, and that's where I will focus my remarks. Year to date, cash operating expenses have totaled \$24 billion for SBC, 75%

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of those are in the wireline. As Ed mentioned, SBC has a very solid track record when it comes to driving costs out of the business. It's been a constant focus for us, ever since the P a c - T e l (ph) merger. Last year, the top line began to change quickly. The economy was weak, the competition was intensifying, and we were affected by the bankruptcies that were mounting across the industry. As a result, we focused our attention on driving out more costs of the business.

We developed basically a two part strategy. First we focused on off-setting the immediate pressure on the top line; we became very aggressive on our short term cost reduction project. We call this "the low hanging fruit." Second, we continued to attack the longer term cost structure and we focused our attention on reinventing and rebuilding our processes, our business functions and our technology platforms.

First, let's look at what we did to offset revenue pressures in the short term. Over the last year, we've taken nearly \$1 billion out of operations and support cost. We accomplished this while we were still investing in the business. For example, advertising in the wireline business has grown 77% year-over-year and we beefed up both of our market and sales forces. These efforts have focused on aggressively penetrating services, like LD and DSL. Which though they require less capital expenditure, the have lower margins than our traditional voice services. We've offset a lot of this initial expense by reducing our operations and support groups. In fact, we've reduced the wireline force by 28,000 employees over the last two years by aggressively matching force and load and productivity improvements. Going forward, forced reductions will accelerate from recent levels primarily through attrition. We've also seen reductions in bad debt; it's down 41% with a large percent of it being driven by the WorldCom bankruptcy earlier in 2002.

Finally, we've attacked the non-wage related expense and you can see some of these results on the next slide. We reduced consultant and contractor services by nearly \$250 million over the last year. We were able to save nearly another \$190 million by reducing travel, laptops, cell phones, right-to-use fees, and energy costs. We've been almost fanatical about these short-term initiatives. Even a seemingly minor change like using recycled toner cartridges and printers rather than new have saved us a lot of money. Our employees have done a super job of being resourceful and contributing in both big ways and small ways.

The short term efforts are important, but obviously, we need to dig a lot deeper. We must have a cost structure that yields far more operating efficiency. So across the entire wireline organization, we're standardizing technology to simplify

operations. We're consolidating centers; we're eliminating regional barriers and migrating to standards OS platforms across the nation. We're also developing new functionalities and enhancing tolls to become more productive and efficient. We're automating and mechanizing processes to optimize workflows and we're shedding costs to I V R (ph) and to the web.

We're working on literally hundreds of projects, and the next few minutes, I want to cover a handful of them with you. First, our call centers. We told you we were pursuing call center efficiency and now that it's starting to really kick in. Our call centers are a big opportunity for us for two reasons. First, their sheer size present real scale opportunities. Second, call centers represent a key customer touch point. In fact, our centers handle more than 200 million customer calls annually, and that's both inbound and outbound. So fine-tuning our processes can deliver big service quality and cost benefits.

Here's what we're doing. We're moving to state-of-the-art systems company-wide. For example, we're developing a fully integrated desktop that will improve our customer rest efficiency by giving them every piece of customer information they need in one database. We're also standardizing technologies and processes in turn, reducing training time and support costs and will improve by automating functions. For example, we begin to incorporate cutting edge speech recognition technology. This will help direct calls to the rep who can best handle the customer. Finally we will consolidate. Right now, we have 200 centers spread across the country, they vary greatly in size and there's a lot of duplication. So we will be eliminating nearly 1/3 of these locations. And this will reduce the amount of new technology we have to invest. The payoff of these efforts is significant. It will shed millions of calls, make customers happy, improve efficiency and also generate additional revenue. The first state primarily involves our consumer calls centers but some of our business and credit and collections.

In addition to the sales calls centers, we're also focused on our network service operation centers. Our network service operations consolidation project is our biggest single project. Right now, we have about 500 network centers, down from 600 about 18 months ago. And these are the centers that dispatch our installation and repair techs as well as handle the design, construction, and surveillance of our network. We have these centers across our 13 states, they vary in size from 10 people to hundreds of people, and currently, they are not uniform. That's what we're changing. Our goal is to make all of our centers consistent, to look and operated the same way regardless of location. At the same time, we want to get rid of overlap and redundancies. One critical part of this involves transitioning

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over to a single suite of operational support systems. Ultimately, we'll be able to substantially reduce the number of centers even more than we have today.

So let's look at a few examples of center consolidation. First our customer service bureaus. These are the centers that handle our consumer and small and medium business repair and maintenance calls. These centers are still organized regionally, with each region using their own legacy systems hand processes. The regional approach has worked well in the past, but now it makes sense to migrate to a national platform. So we're establishing nationwide network customer service bureaus. This will allow us to standardize operations, reduce the number of customer service sites, save millions of dollars and improve customer service. We've already reduced the number of sites by 40% since 2002 and we'll connect the nine remaining centers by implementing one common trouble entry system and implementing a standards customer interface. This will give us the capability to share workloads across time zones and geographies in instances where we need to manage peak time calls and weather-related volumes. And we'll have the redundancy we need in the event a center becomes inoperable due to a disaster or even a power failure. The national service bureau will be in place next year. By the way, we are approaching this project real carefully. Our goal was to avoid building new buildings while minimizing severance costs and we are accomplishing that.

Now, let's look at our electronic switching administration centers (or ESACs). These facilities are responsible for the highest level of technical support within our regions. They perform emergency recovery and outage restoration, handle the testing and analysis when there's been a critical service interruption and they ensure the integrity of the network software. Until now, each of our regions has managed by using their own technical expertise to maintain every regional system. So here, we're also moving to a national platform. We're eliminating the overlapping regional expertise and we will share the knowledge across the enterprise. We are also reducing our reliance on vendors and transferring this knowledge in house. By managing this nationally, using our own employees, we can tap into the very best technical expertise across the enterprise. We expect this to both improve reliability and reduce costs. I've given you three examples of what we're doing in our centers. Now let's take a look at some of the things we're doing with our new efficiency tools and technologies.

Our outside plan engineering team needs ready access to thousands of pole maps (ph), cable records, cable and pair information, distribution area maps and conduit records. As you

might guess, this is a very time-consuming process with a high risk of error.

So we're converting all our outside plant records from paper to PC. When designing circuits, for example, engineers used to have to calculate cable footage and determine resistance loss for each segment of the cable. Now, they simply enter the cable and pair information and the system provides the data.

Also, manually updating cable records used to take three to four hours. Now, it takes three to four minutes because one simple entry ripples through the system updating all our records. This system provides efficiencies and reduces errors and that improves service by shortening intervals and saves us money.

We're also employing new software and technology that will leverage our existing GPS technology so we can better manage our field technician dispatches. Our current dispatch system assigns technicians as they become available to the next priority job in a large service area but it looks at a service area. It doesn't, for example, look at which technician is closest to the job based on the current location, travel route and traffic patterns and it doesn't take into account the skill sets of that employee.

This new system creates the most efficient dispatches possible by analyzing all these factors. This will enable us to refer the highest priority work to the closest technician who is best qualified. This will reduce travel time, particularly in large cities like L.A., San Francisco, Chicago and Dallas and boost productivity because it makes sure that we're using the best talent we have to handle those jobs. Annually, this equates to 30 million miles and 750,000 hours saved. Our first office application is in the southwest region. This month and we'll implement this system fully in all our enterprise next year.

The next project I want to show you involves enhancing the tools we use to manage our 3200 central offices across the country. This management dashboard you see provides a single source for our managers to obtain key information regarding workload, force, alarms and a lot of other data.

It is a quantum leap, trust me, from what we had before. A manager can now look at this chart and see the workload for a specific workgroup or an individual whether it's a DS3 circuit that needs to be installed, provide basic dial-tone provision on a DSL order or perform routine central office maintenance and the other good thing is all levels of management have access to this data which improves accountability.

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It's also presented in a user-friendly web format. And before a central office technician repairs, tests or installs a piece of equipment, he can pull up a detailed - he or she can pull up detailed instructions on what they need to exactly do. So whether it's performing maintenance on a SS7 unit or installing a card in a . This may seem pretty basic to you but we believe this is going to be a major timesaver.

It will help manage our force a lot more efficiently. It will allow us to increase our spans of controls within our central offices and our network operations centers and it will improve job accuracy and improve quality of service.

All these projects are about driving efficiency every way we can. It's about saving money and making it easier for customers to do business with us. It's about driving world-class excellence across our enterprise.

Internally we talk about this in terms of best in class. The idea is to recognize each wireline group that achieves the best metric in any given area then we hold that metric up as the new standard that all the other work groups have got to meet. Once they rise to that level, they we raise the bar. So we have continuous improvement across the enterprise.

Even a modest improvement in these metrics leads to tremendous expense savings. For example, a 3% improvement in our POTS productivity can save us \$40 million annually and I guarantee you we're planning to drive it up a lot more than 3%.

All this helps the programs that I previously talked about. We see \$550 million in cost savings opportunity through our best in class approach. Collectively, these longer term productivity improvements will save us more than \$1.3 billion in annual capital and expense by 2006. I want to emphasize that these numbers reflect our productivity savings only, not any additional savings we'd realize by matching force to load if load continues to drop.

Of course, we have our sights set on even more savings in the years to come. And that's because cost control for us is not a one-shot deal but it's a continuous process from here on out. We have made good progress so far but it's not nearly enough and we know that and there's going to be more to come. All of the new growth opportunities Ray described require limited cap ex but they will drive up expense. So we have to do everything we can to drive down those costs to help preserve our margins and compete in this marketplace. It's especially important for our DSL and LD products.

So that's a brief look at what we're doing to manage expense at SPC. We've done a lot so far but in many ways, we're just getting started. I've just hit a few of the highlights today but, trust me, the scope of this is broad and deep. It's no exaggeration to say that we're essentially reinventing our company around the new reality of our industry.

We're throwing out old assumptions, old paradigms and old ways of doing business. We're asking ourselves, what kind of cost structure are we going to need to compete in the years ahead. We know we don't have that cost structure yet but we're well on our way and we are going to get there and the exciting part is, is that the pay off is huge.

Thank you very much. Now, I would like to introduce our good friend Stan Sigmun who'll update you on Cingular.

Stan Sigmun - President and CEO - Cingular Wireless

Thank you, John and good afternoon to all of you, again.

I'm pleased to be here to speak about Cingular, about its operations and about its opportunities. I hope most of you know by now, I'm encouraged by the traction we're getting with operations and I'm very optimistic about the opportunities in front of us.

We have the assets, the scale, the financial strength plus the advantage of our bloodline back to SBC and Bell South, all of this is an opportunity that many companies don't enjoy. We have made progress in most aspects of our business over the last year. We turned Cingular into a good business. We're still not right. I know that; but I guarantee you that we will execute relentlessly until we get there and we will.

At Cingular, we're focusing on four key objectives. First, maximizing long-term growth and profit. We are delivering in the market today while positioning Cingular for the future. Second, our GSM conversion. This bring new opportunities, efficiencies and benefits so we're moving quickly and we're moving well.

Third, our integration with wireline. We can't overstate the importance of integration of Cingular, SBC and Bell South. This is an opportunity we will pursue aggressively and fourth, another opportunity. Yes, wireless number portability. I'm sure you want to know our expectations around this, our plans and wonder whether we can sustain our growth going forward with this issue in front of us.

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Well, let's briefly review what has been accomplished before we talk about where Cingular's going. When I arrived at Cingular about a year ago now, I saw more promise than performance. My priority has been to get the company growing again, quickly and profitably.

The first step we took was to put leadership focus back in the local markets. To let those that were closest to the customers and the customers' issues make the customer impacting decisions. We put sales, marketing and P&L responsibility and accountability back in the local markets and the results were pretty impressive and immediate.

Our second focus was improve our marketing message. We needed something our customers could get their arms around, that goes to our "Cingular fits you best". A tag line that matches our intense focus on the needs of each customer.

The third change was to capitalize on our relationship with SBC and Bell South. Initially, there was no brand association with trust, stability and service quality that's inherent with the wireline brand. Cingular added this tie in to its advertising and as you've seen in our numbers, it is making a difference.

Gross adds have grown for the fourth consecutive quarter and reached nearly 2.7 million last quarter, our best quarter ever. Up 21% from the second quarter. Looking at gross adds share over the last four quarters, Cingular's results are clearly from solid market performance not just riding industry growth.

Our 21% flow share of gross adds during the quarter represents three quarters of continued improvements. Moving Cingular from a distant fifth to a solid second place in less than a year. We have reestablished Cingular in the marketplace. We have solid momentum and we are moving towards best in class.

Our winning in the marketplace is partly driven by our extensive retail distribution, 86,000 strong. These channels are performing well but another channel, the wireline channel, gives us a long-term competitive advantage. A key - a big key to our recent subscriber growth has been the wireline distribution channel mostly from SBC.

The massive wireline sales channel are second only to Cingular's own direct channels and their ability to sell and the acquisition cost associated to this channel are among the very best. Third quarter gross sales by this channel, the wireline, totaled 295,000 or 14% of total Cingular sales and most of these sales were bundled with wireline services on a single bill.

Our regained focus shows in the numbers. The 745,000 net adds for the third quarter was the highest since the first quarter of '01 and 92% of our net adds were contract services, post-paid; that's 687,000 contract customers, a Cingular best.

We've done all of this despite the fact that we were deeply involved in a GSM overlay. Revenues of \$4 billion in the quarter were up 4.4% sequentially but as you saw and know, our margins were under pressure and customer churn is too high. The current margins and churn rates are unacceptable. We know that.

We know what is causing this and we know what we need to do. It won't be fixed overnight, but it will be fixed. Customers basically their service subscribers based on network performance, customer service or price. Cingular is working aggressively to reduce the churn and improve the margins. We're committed to break out of the pack and close the gap on the best in class for growth, churn and margins.

To move these metrics, we have to improve the customer experience. We recently identified 14 key initiatives that are impacting opportunities for us at Cingular. These initiatives are designed to improve our customer experience from the day the customer begins thinking about buying wireless until the day they are a long-term customer for Cingular.

It is simplifying processes to drive long-term benefits for both the customer and for Cingular. The results will be more satisfied customers with fewer reasons to call us about issues, fewer issues to address around service, billing, payment and so forth.

Cingular will benefit from this with lower churn, lower costs and higher margins. We have short sayings at Cingular. One is, "what gets measures gets managed and what gets focused gets fixed". This issue is being focused on and it will be fixed.

To succeed in a competitive filed like we're in, we must have a fundamental strong foundation to build from. Our network footprint is that foundation. It is extensive with 263 million POTS and 23 million subscribers. To further enhance our network, Cingular's agreed to acquire spectrum from Next Wave covering over 83 million POTS for \$1.4 billion and should close in early '04.

This spectrum is heavily weighted in major markets where Cingular already operates, this expands the depth and reach of our networks and our average spectrum in the top 100 markets increases from 30 to over 34 MHz. We will see some immediate benefits from this spectrum that'll serve us better in long-term growth.

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Additionally, we've been actively acquiring and swapping spectrum from other carriers. Recent deals include locations in Texas, Florida, Maryland, Louisiana and Arkansas. Achieving a nationwide GSM footprint is essential for our future. GSM provides us with the most advanced application, handsets, economies of scales, data voice capacity, a quick path to higher data speeds and enhanced international roaming.

These are two - there are two parts of our GSM effort. The first is to transition our own network to GSM. Cingular's GSM overlay is ahead of schedule as Mr. Whitacre mentioned. We've converted 92% of our covered POTS, including all of our major markets and the remaining areas to be converted, shown here in the blue, will be done next year.

This transition is complex but our overlay approach has been smart. We know GSM, we understand the technology and we know what it takes to do it right. Feedback from these customers that we've converted has been good. With GSM we're now beginning to enjoy the unprecedented new products, the efficiencies and the customer experience we expected.

The second part of the GSM conversion is an effort to ensure nationwide GSM coverage either through our network, joint ventures, or through roaming partners. We have been working aggressively with other carriers to get this done. 30 new U.S. GSM roaming agreements have been signed since the 1st of the year. Even more impressive is that these agreements allow us to roam at half the rate of the traditional TDMA rates.

By the end of the year, the GSM networks of Cingular and our roaming partners will cover nearly 90% of the entire U.S. population and increasing to almost 94% by the end of '04. Most importantly is that we provide roaming - or network services where our customers use their minutes. By the end of this year, we'll have GSM service available where 93% of our customers use their minutes today and increasing that to 99% by the end of next year.

When you add all of this together, you're looking at a national carrier with a strong local focus. Combining Cingular's extensive network with the footprint of the wireline assets creates a far-reaching asset base to launch new integrated services.

80% of Cingular's 23 million subscribers reside where SBC or Bell South offer wireline services and the vast majority of their 79 million access lines are within Cingular's service area. This represents significant opportunity particularly when you look to number portability.

And we're ready for number portability. We have been retaining our best customers, increasing our customers under contract to over 70% with the majority on two-year contracts. Handset upgrades have been instrumental in attracting many customers to new contracts with 9% of our base upgrading to GSM handsets in the last quarter.

And, as we have said, we are nearly complete with our GSM overlay. The GSM handsets are driving customers into our stores. Store traffic is up 40% in some of our most recently converted markets. The benefits to Cingular with this is more than just getting customers on new contracts but it helps migrate our customers to our new network. We now have 40% subscribers on GSM handsets, up from 35% just six weeks ago.

We have signed portability agreements with all other major carriers. Operationally, we have upgraded our systems to port customers and our portability call center is ready to go. And, as Ray mentioned, we are under-penetrated in the business market which represents less than 10% of our customers.

This is an opportunity we plan to exploit with number portability. The really big opportunity will come with products and services that give the customers the benefit of both wireless and wireline. The mobility of wireless and the security, convenience and reliability of wireline.

Customers want both and we believe we have the companies - we believe that we are the company that gets this basic point and we can give the customers the benefit of a single number and we already are doing that with our fast forward service and we can win with this in a big way; that's where we're focused.

Most of the early conventional wisdom seems to think about number portability that it's an either or term but the fact is, from the customer's point of view, it's not a technology decision. It's about value and benefits. We believe the customer will move beyond either or to a both and concept where they get the value of integrated wireless and wireline with a unified set of features. They get extra reliability, they also get access to DSL.

We've already taken huge steps in this direction and we have a lot of potential in front of us. It won't be long before the customers not only have the ability to integrate wireline and wireless products, but they'll expect it and with the largest wireless wireline overlap, Cingular, along with SBC and Bell South, bring a value proposition that it'll be difficult if not impossible for most to meet.

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We started this integration process with the single bill. Then we added your combined wireline, wireless voice mailbox. Recently we added the PC to wireless messaging capability. We just broadly launched our fast forward product and sales are approach a thousand a day. In the near future, SBC will be launching unified communications which allows for integrated messaging, e-mail, wireless and wireline voicemail.

We are also working on the integrated Wi-Fi solution allowing customers to enjoy a seamless broadband experience between home or office. SBC's freedom link Wi-Fi hot spots and Cingular edge network. We believe these kind of efforts are a competitive advantage and we intend to exploit them on an accelerated basis. And the integrated product portfolio that positions us to win in near term opportunity, wireless number portability is an opportunity.

Cingular is a much - is in a much different place than it was 12 months ago. We have made progress. The intensity and speed in which management has grasped this is gratifying and, as you can see from all this progress, Cingular is a much more productive asset for its owners. A much more valuable asset. It is stronger operationally and it is better positioned for the future.

Going forward, we will continue to invest in our networks. We continue to improve the customer experience. We will exploit new products and market opportunities and will differentiate through integration with wireline.

At Cingular, we know our strengths, our opportunities and our customers and we will execute with a driven focus. I thank you again and now turn it back to Ed for closing comments.

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

Well, thank you very much, Stan. I know you have a lot of questions, so I won't take much time here but let me quickly recap some important points.

We do have a clear, focused plan at SBC and we're beginning to deliver good results. We do have a proven record of execution in DSL, long-distance, wireless. And in cost management, we're executing at a high level at SBC and you can rest assured we will keep that intensity high.

Third, SBC has substantial opportunities ahead. Long-distance in the Midwest, the large business space, SBC dish, Cingular and in DSL where we think we've just scratched the surface.

There is a lot of opportunity ahead for SBC. Plus, at SBC, we have a strong balance sheet and we have the financial strength to execute our major initiatives and return value to our owners. I have a lot of confidence in our ability to get that done.

Looking ahead to 2004, you can expect two things from SBC. Strong effective marketplace execution and disciplined cost management. We are confident as we move forward, we will see revenue trends stabilize leading to positive year-over-year growth by the end of next year, that includes the results from Cingular.

We expect DSL net adds to continue to ramp. We expect consumer retail long-distance penetration of more than 40% companywide by next year and we expect Midwest access lines to trend with what we've seen in other regions.

Our marketing initiatives - our marketing initiatives are going to continue to have an impact in margins in the near term. With progress on access lines and revenue and with continuous improvement on the cost side of our business, by the end of next year we know margins will stabilize.

You can expect us to be very disciplined on cap ex. 2004 is now targeted at \$5 billion. And you can expect that we will put a premium on returning value to our shareowners. Again, we have good opportunities ahead at SBC. We're executing at a high level and I'm very confident in our ability to deliver to our shareowners.

With that, I'd like to ask, not only our presenters, but the rest of the senior management team at SBC to come on up, Randall, all of you come on up. This is not in the script but since we're going to answer any question about SBC, you should see the senior management team and we do have the best management team.

QUESTIONS AND ANSWERS

Stan Sigmund - President and CEO - Cingular Wireless

All of us are available for Q&A and so, we're ready for the first question.

Yes.

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Unidentified Participant

This is a question for Ray and, I guess, also to an extent Randall. Ray, you did a good job of segmenting the business market for us and clearly the biggest dollar opportunity for you is the large business segment and that's even just looking at the business who are largely based or up to 50% based in region in terms of where their footprint is or where their premises are.

I wonder if you could talk a bit to your ability to be cost-competitive, because on the one hand for large business, clearly you have an advantage in region from a cost of goods sold point of view. You have ubiquitous last mile access but as you go out of region there's something of a disadvantage as you have to buy last mile access from others?

And also, I wonder how the cost equation works, particularly in terms of service and support competing against the who've got very big in the scale in the large business market? And, I guess, the bottom line is, if we look at the I X C (ph)'s you know, they're achieving what - you know, by SBC standards, would not be particularly good margins at the 15 to 25% level roughly on an EBITDA basis.

You know, can you compete and, if anything, get above that margin level which, I guess, again from Randall's point of view, isn't the sort of figure ideally you'd be aiming for?

Rayford Wilkins - Group President - Marketing and Sales - SBC Communications Inc.

Well, I think you almost answered your own question. When you look at it overall, the last mile or the presence at the local level really determines a lot of the cost factors. When you start looking at the long haul network, the incremental cost is very, very small.

One of the reasons we're focusing on those customers that have a lot of their locations in our territory is because as you look at a combined network, both in region and out of region, we believe that we have a cost advantage over AT&T, MCI and others because they buy a lot of their local access from us and or the other regional Bell companies.

As a result, we are having a focused approach towards the enterprise marketplace. Once again, that doesn't mean that we won't go after other opportunities and we'll be selective as we do that but we know that, on those, we have a cost advantage.

On the long haul network, our costs really compare pretty favorably with the carriers. We have to, of course, become very effective and efficient in acquiring local access out of region but remember, we have switches right now in 30 regions outside of our network.

So we believe, all in, we can be very price competitive and, in fact, on a lot of the bids that I'm looking at right now and I see a lot of them that go across all of the different regions, we are being very cost competitive.

Unidentified Participant

OK.

Unidentified Participant

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

Long question, long answer. Yes, sir.

Unidentified Participant

Thanks, actually a question for Bill, I think. As you look at the S V C (ph)'s review, what do you think the timing is of some type of final decision from them? Then what do you think the process is going to be to actually - if you hypothetically say that they do improve the methodology by which t e l r e c (ph) is calculated, to actually turning that into a positive impact on wholesale prices?

Bill Daley - President - SBC Communications

Our best guess is probably somewhere around nine months. So we're talking late Spring of '04 and then we would expect an aggressive program at the State level to get the States to then respond and come up with some rates that are realistic considering the changes they'll make.

We do have some States moving forward right now on u n i (ph) prices and we expect there to be some success on a few of those. But I think nine months is probably a realistic date and then after that within six months we should see some State action released.

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Unidentified Participant

Fair enough.

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

Yes, sir.

Unidentified Participant

Thanks. One for Ray and one for Randall. Ray, can you talk a little bit about the video strategy? How aggressive you plan on being on marketing and, kind of, what your target might be a couple of years from now in terms of subscribers?

And, Randall, Ed was kind enough to give us the, kind of, hurdle that revenues will start to grow again by the end of next year. Can you talk a little bit about earnings, when you think that might be able to start growing again?

Rayford Wilkins - Group President - Marketing and Sales - SBC Communications Inc.

Well, in terms of -

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

He can't talk about that. But he'll talk about it. Go ahead, Randall.

Randall Stephenson - CFO - SBC Communications

He'll talk about the other one, I won't talk about it. In terms of SBC dish, we're rolling it out through all of our States initially. We think that we're going to be very, very successful. I'm not going to release actual targeted numbers. I have them. In fact, Ed and I have talked quite a bit about them and he said the bigger the better is what he told me.

But I really believe that we're going to be very successful with SBC dish but I'm not releasing any targeted numbers right now in terms of overall growth.

Rayford Wilkins - Group President - Marketing and Sales - SBC Communications Inc.

In terms of earnings guidance or earnings forecasts, obviously we don't give earnings forecasts at all. We have some of the best and brightest analysts in the country in here and I think based on the historical trends of what we've given you, somebody as smart as you, Tim, would probably do a good job at that.

But we do expect margins to stabilize though towards next year. You know, the preponderance of our margin pressure is not pricing. Our margins pressures are coming from access line losses and the lion's share of the access line losses are Midwest and you've seen what you ought to be able to expect as we penetrate long-distance in the Midwest. So as you slow down access line losses, margins should stabilize towards the end of year, next year.

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

Yes. Up there. Yeah.

Mike Coffee - Managing Director of Investor Relations - SBC Communications Inc.

OK. We have a question in the balcony.

Unidentified Participant

Ray, I'm going to question on DSL. You indicated that about 50% of your lines - or over 50% of your lines can achieve 4 to 6 megs, and a couple of questions in that respect.

First of all, are they concentrated enough so that you can actually target market to those customers or are they scattered because of distance from the CO difficult?

Second, when will that kind of speed be relevant, really, to a business plan? And, third, what are you expecting as it relates to cable companies cutting price and when this will, sort of, come into play. What's embedded in your business plan in that respect?

Rayford Wilkins - Group President - Marketing and Sales - SBC Communications Inc.

OK. Let me begin with your first question. They are concentrated enough. They're all under eight kilo feet (ph)

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from the Central Office. We know where they are. We have demographics associated with those. Also, there is the ability to go at the RT and really begin to deliver even higher speeds even past the RT. So we have roughly 50% of our customers right now who can get that four to six megabits and it really becomes relevant when applications really drive the need for increased speed.

We do sell a lot of speed tiers right now, as we call them, particularly in the business segment where you have applications that really require that type of bandwidth. But down market in the consumer and mass market areas, those applications really don't exist right now.

Most applications and or servers are at about one and a half megs. So, we are ready and poised as those applications develop. And if you go and look at some of the European areas and if you look at the Asian community, they have some applications now that are beginning to require those speeds.

So we are poised and ready to deliver those when those applications develop. What was his other question? Oh, price compression from cable company.

Right now, we're not seeing much movement other than Comcast. They've got a couple of small switching offers at lower speed levels, 768 kilobits and below. We believe that the value proposition we've put in the marketplace at \$26.95, 1.5 megs for our package - packages right now is a much better value and right now we're not seeing any trail off at all in our sales.

So we feel very optimistic that we can compete with the cable companies. But if and when the need arises, we will compete and we will be the broadband leader.

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

In the interests of making that maybe more clear, the engineering strategy in the Midwest and California call for more central offices and less distribution plan. So, in those cases, in those two companies, it's more concentrated and we're able to coral a little better than Southwest which tends to have longer loops. But the answer to your question is exactly what Ray said and that is, we do have a handle on it and can reach it with those kind of speeds.

Yes.

Unidentified Participant

Randall, a couple of questions. John had talked about achieving cost reductions of about 1.3 billion annually by the end of 2006, can you comment on what costs would need to be incurred to get at those kind of savings or, alternatively, what kind of payback you'd be looking at.

And, secondly, on pensions, that would obviously be embedded within your margin trend comment, can you give us an idea of what assumptions you're looking at?

Randall Stephenson - CFO - SBC Communications

Yeah. The first one, in terms of what kind of investment's going to be required to get the 1.3 billion, there are going to be some capital costs incurred. They're more in John Stenky's organization. It's IT type development to make most of that happen. Some severance, although not significant amounts of severance. We think we'll be able to do most of this with attrition.

And so, bottom line, you know, we're looking at spending 5 billion this year, 5 billion next year, inherent in those capital numbers are the costs required to do these initiatives. So it's not significant enough that it's going to move our capital forecasting by much.

In terms of the pension and retiree medical costs for next year, we're not looking at significant pressure going into next year. I'm not going to give assumptions in terms of what's behind those but, at this stage, given what we've got behind us this year, it doesn't look like we're going to have significant pressure from those lines going into next year.

Unidentified Participant

OK.

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

Any other questions? Yes. It's hard to see who that is; is that you, Richard?

Unidentified Participant

Yes, you've got it.

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Edward Whitacre - Chairman and CEO - SBC Communications Inc.

OK

Unidentified Participant

I understand what you were saying about the opportunity for linking up wireline and wireless but I was wondering if you could touch, or anyone on the stage really, could touch on the issue - kind of some expectation on how much you see wireless substitution accelerating going into next year assuming wireline to wireless number portability expands?

I don't know if there's any easy answer to that.

Unidentified Participant

There isn't an easy answer and I probably can talk about that as well as anybody. It's going to continue to accelerate. There will be substitution of wireline for wireless. We don't know. It's probably 7% or 8% now. It's hard to know. How much higher it goes, I don't know but, you know, wireline's not going away. I personally think it's not going as high as you might be led to believe by reading.

I do think there are tremendous opportunities, as Stan explained, between the wireline and the wireless companies but I don't know what the percent goes to next year. I don't know how quickly that goes. Fast forward certainly helps. Other things help but we're convinced it'll continue to grow. We don't know what that number is.

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

Yes.

Mike Coffee - Managing Director of Investor Relations - SBC Communications Inc.

Mr. Whitacre, we have a question in the back of the room.

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

OK.

Unidentified Participant

Thanks, Ed. We touched a little bit on cable telephony but just to dig a little bit further into it, obviously Cox has proven they can take share with the circuit switch offer it has now and, you know, they've talked about voice over IP, maybe that being an impact for you maybe in '05.

I'm just curious, you know, you're looking for lines - trends to improve late next year, how big a threat do you view that right now and how aggressive do you need to be today in response to that anticipation of it?

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

Well, I think we need to be vigilant. I think we know we're going to lose lines to other technologies but we're also very aggressively looking at voiceover IP, utilizing it. What we're after, I'm sure it's no secret to you, is market share and attractive prices. Things that enhance our services to our customers.

But we have to be very vigilant about that. We have to be prepared to meet them in the marketplace. Are they going to take some share? You bet. Are we going to take some? Yeah, we're going to take some back from them too.

So we just have to be all over that and we are. Forest Miller (ph) is spending a great deal of time on that effort and so all I can say is we're on top of that. We know - as you know, there are a lot of regulatory questions, maybe even legislative questions around some of these technologies. But given the past track record, you can't rely on that so we have to be ready to go and we're trying to get ourselves in that position. It's - it's who gets the consumer or who gets the customer and that's what we're focused on with bundles, with prices, with all that kind of stuff. Yes.

Unidentified Participant

Two quick questions for Mr. Whitacre on the video product. There's been some discussion about your price point for the triple play being \$100 for voice video and data; does that seem reasonable? And then, second, in terms of prioritizing markets with the video product, is the idea to go after areas where you've suffered the most losses like in San Diego or is it really a blanket strategy across your entire footprint? You know, kind of inoculate yourself from the next round of competition.

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Edward Whitacre - Chairman and CEO - SBC Communications Inc.

I think both of those make sense, but Ray wants to add to it. Ray.

Rayford Wilkins - Group President - Marketing and Sales - SBC Communications Inc.

Well, right now because I want to hit the marketplace pretty hard but let me assure you, we're going to be pretty aggressive when we roll out the SBC dish product. Yes, we will go into San Diego very hard but we'll go other places as well. It won't be just a total blanket strategy but it will be one really targeted towards picking up as much market share as we can in the shortest amount of time frame. We really plan to hit the market pretty hard with overall SBC dish.

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

Yes.

Unidentified Participant

Thanks. First a question for Ray. I was wondering if you could talk about the methodology that you used to calculate the improvement in churn on the different bundles? And can you talk about the potential risk to the analysis since the bundling is still so young for a lot of your customers that the denominator is growing really fast but the numerator, which is the disconnects, haven't had a chance to catch up.

And then secondly, for John on cost cutting, it sounds like you're pretty far out of the gate in starting this process and I'm wondering if you could talk about how much of the savings will flow through the P&L over the next couple of years before you get to the finish line which is the 1.3 billion?

Rayford Wilkins - Group President - Marketing and Sales - SBC Communications Inc.

OK. If you look at the in service life expectancy, we've been tracking that for a number of years. We know what our initial bundles are, we know what they are in long distance. We've had long distance in Southwest for three years and we've had DSL for over three years.

But while they are new, really churn has been analyzed and looked at with in service life for at least a three year period. So it's not quite as short as you might expect. What we do know is that as we add additional items to the bundle, that churn goes down and we can measure it very scientifically.

So we know exactly what the in service life is from one product to the next product and with multiple bundles.

John Atterbury III - Group President -- Operations - SBC

The average payback period on the majority of our projects is between two, two and a half years. And we started a lot of these projects in the latter part of 2002 and, for example, in 2003 we saved about as much of expense in 2003 as we spent on the projects. But we won't get the full benefit until 2006 for the most part. Two and a half years on these projects.

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

OK. Over here.

Unidentified Participant

Hi. Number one, would you take a look at MCI at the right price once it comes out of bankruptcy? Had to ask that, sorry. Number two is, the guys outside are saying that you're going to offer a voiceover IP product out of region, won't that anger your Cingular joint venture partner in the Southeast?

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

Well, for your first question about MCI, we're focused on growing our business. We think we have a good strategy and we are going to focus organically or what we told you about today. We're going to grow our company organically.

Secondly, I've forgotten what it was. Something about Cingular; what was it?

Unidentified Participant

Apparently you're going to be offering a voice over IP product out of region; won't that anger perhaps Bell South and -

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Edward Whitacre - Chairman and CEO - SBC Communications Inc.

Well, absolutely it will. And just like if they come in it's going to anger us. Of course, the answer to that is, yes, but it's a non-issue since we have a good partnership and it's not happening. Impossible to speculate on things that don't happen. It's kind of a curt answer wasn't it but I don't know how to answer that any differently.

Yes, Bill.

Unidentified Participant

I have a question for Stan that's somewhat similar. You've made a powerful case as to how you combine wireline and wireless in each of the territories for residential wireless customers; how do you see approaching the business customers and linking that with the various parent wireline?

Stan Sigmun - President and CEO - Cingular Wireless

First of all, thanks. I'm glad you asked me that question.

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

Give him the microphone.

Stan Sigmun - President and CEO - Cingular Wireless

I'm glad you asked that question because I would hoping you'd ask a question; that's the first time I've ever seen you out of a bow-tie. As I tried to mention in the slide, the B-to-B channel or the B-to-B market, small business all the way up to the enterprise, there's a tremendous opportunity for Cingular because we don't have a presence there.

We're basically, by and large, and Ray showed it on his graph in the total revenue opportunity where Cingular is, we're a consumer market. And we haven't gotten traction in the business market because we've been guilty of trying to force business and enterprise into consumer distribution channels, consumer rate plans, consumer operational support systems. We get it. We're fixing that.

We're aligning ourselves with a relationship with Ray and his distribution channel has with those accounts and number

portability brings opportunity for us in that regard because the number is really important to those customers.

And to give up that number and come over to another carrier, we had to create the reasons. So, we've got to create the systems and the price points and the products and operations. And we've got to leverage off the relationship that Ray and his channel already had. Does that answer your question, Bill? No?

Bill Daley - President - SBC Communications

Unidentified Participant

Bill, let me take a stab at that ...

Unidentified Participant

Get the microphone.

Unidentified Participant

One of the things that we're looking at right now as we approach the large business segment is to really take the lead in terms of bringing Cingular in more than we have in the past.

There are a couple of key things that are going on in the business marketplace right now I talked about a little bit earlier, convergence. As you put all of those features on a converged network and as the demonstration shows out there — you can do things like follow-me type services that allows a single number for that particular individual in that enterprise to go anywhere they are and they can actually be followed based on the voice-over IP technology.

The next thing that we'll do is we'll have what we call the single mark. A single, minimum annual revenue commitment that will also include Cingular spin as part of that overall discount that that enterprise could have by doing business with SPC versus some other company. So, there are several different ways we can link it up.

Unidentified Participant

We're going to try to be very close with Cingular and our sales force, Bill, in the business enterprise arena.

FINAL TRANSCRIPT

SBC - SBC Communications Analyst Meeting

Mike Coffee - Managing Director of Investor Relations - SBC Communications Inc.

Mr. Whitacre?

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

Yes?

Mike Coffee - Managing Director of Investor Relations - SBC Communications Inc.

Mr. Whitacre, we have a question in the balcony.

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

OK.

Unidentified Participant

Thank you. I wanted to ask you a question about fiber to the home. I wanted to get your thoughts on whether you're a proponent of an overlay versus a new build? Whether you plan to roll out fiber to the homes -- to either the home or to the neighborhood?

And then, what would be the applications you have in mind to justify the cost of building out the fiber?

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

Well, that's a multi-part question and I'll try and then people can chime in. We don't see the economics of putting fiber all the way to the home at this point in time. But we clearly are extending fiber in our network.

We don't want to tear up everybody's driveway, street, alley and there are still some regulatory uncertainties. For example, as you know, broadband in a green field situation is supposed to be unregulated.

But there is a question -- Jim, correct me if I'm wrong -- under the 271 portion whether we have to provide a path to the house or not. So, even under 251 it's not required. It's a question of

under 271, we may still have to provide those who want a provide a competitor to the house.

So, we don't know the answer to that question. That being uncertain, that certainly would deter you from making any further investment. The services -- so, we're putting fiber further out, much further out. The justification of that, of course, is higher speed DSL type services, broadband, video -- be it switched or broadcast -- all those types of services would be the justification for that.

Unidentified Participant

In a flat capital spending environment, could you let us know what your priorities are going to be for outside plant versus Legacy systems versus next generation IP systems?

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

Well, Mr. Stanky over there who runs IP is going to get a big chunk of it as we consolidate centers and try to have common suites of systems to give our customers better service. In our core business we're going to maintain essentially what we have. And those needs are about like they've been in the past, right?

Unidentified Participant

About that, yes.

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

Not significantly different than maintaining our core network. And the remainder is scattered over voice over IP projects, those sorts of things.

Yes?

Unidentified Participant

A question for Stan and perhaps Randall. To what extent or what chance is there that LNP would be disruptive enough so that you can actually see some of the consolidation that we've all been talking about for the last four or five years? Thanks.

FINAL TRANSCRIPT

SBC - SBC Communications Analyst Meeting

Stan Sigmun - President and CEO - Cingular Wireless

Well, I cannot gauge (ph) it. LNP is not going to be good for the industry. It's not going to be good for any carrier in the industry short term. As all of you all know, there's not a carrier in the industry that's earning its cost to capital. Cingular is best in class in that.

And so, this is going to be taking cash and giving it to the consumers. It's a good thing for the consumers, but it's not good for the industry and it just makes a weak industry weaker. There's no doubt about it.

Unidentified Participant

This question is ...

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

He's had his hand up a long time.

Unidentified Participant

And it's an easy question.

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

Oh, good.

Unidentified Participant

For John -- because it's a math question. John, I was looking at the 1.3 billion you had built up in savings for 2003 or by 2006. And I was kind of flipping back at what the components were and I had -- I just want to make sure I've got this right.

I've got 550 million of that coming from productivity. Mainly from service tax and central offices and so forth. And then there was another 417 in non-wage it looked like. When I added up all those little pieces you had in your chart.

And then that leaves like about 333 million or so of something else. Could you let me know if I've got that right first, one? And then two, is there another 333 of something that I need to know?

John Atterbury III - Group President -- Operations - SBC

Well, you're not exactly right, OK? First of all, the 1.3 was both expense and capital. Clearly, the majority is expense. The 550 is in the 1.3, but I didn't talk about all the other things.

I mean, the call center consolidation can fit into part of that 550 as well, OK? Because some of those metrics measure call centers. Those best in class metrics. So, I didn't talk about the, you know, like five or six cases out of maybe 100. But when you add up all that 100, that's what the 1.3 billion is. But the 550 is in the 1.3.

The 417? That's short term. No. No, no, no.

Unidentified Participant

John Atterbury III - Group President -- Operations - SBC

Yes, yes, yes. I'm sorry.

Unidentified Participant

OK. Yes, sir? He didn't want you to have the Mic. There.

Unidentified Participant

This is a question for Stan. Stan, if I remember correctly from your Monday presentation, you said that churn among your GSM customers is higher than the T D M A (ph). And I'm just kind of curious if that is -- it's not true? Oh, OK.

Stan Sigmun - President and CEO - Cingular Wireless

I don't recall saying that and if I said that, that would be -- I don't know where I would have said that from. I don't recall saying that.

Churn from our GSM customers is higher than our T D M A (ph) customers? I don't think that's true. Yes?

Unidentified Participant

OK.

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SBC - SBC Communications Analyst Meeting

Unidentified Participant

This question is for Mr. Sigmun. I was wondering if you could tell me, what is the average length of time remaining on your wireless customer's contracts? If you can't be specific, could you at least say whether it's more or less than a year?

Stan Sigmun - President and CEO - Cingular Wireless

It's more than a year. As I mentioned it in my presentation, we have 70% of our subscribers under contract. Most of them are on a two year contract. I can't be more specific than that right now.

Unidentified Participant

Yes?

Unidentified Participant

Yes, this question is for Ray. I'm trying to get a handle on the consumer market. You know, you talked about your own churn there. Do you have any intelligence on what your competitor churn is? Particularly AT&T and MCI?

And I guess, secondarily, can you talk about gross losses or gross losses going down in addition to net losses? Thanks.

Rayford Wilkins - Group President - Marketing and Sales - SBC Communications Inc.

Sure. If you look, first of all, at our competitors churn I don't have their actual statistics. I'm trying to drive it up higher than it is right now. And I can tell you that our win back rates have increased substantially, particularly in the Southwest and West.

Let's take the West, for example. In the first quarter our win back rates there were 38%. We're now hitting at 66% win back rates. That means they've got to be going up substantially. Southwest went from about 66% in the first quarter to 86% in the third quarter.

So, I don't know what their churn rates are, but whatever they are, they're going up. And my job is to make them go up faster.

Unidentified Participant

That's a good answer. That's a good answer!

Rayford Wilkins - Group President - Marketing and Sales - SBC Communications Inc.

Now, what was the second -- you had another question?

Unidentified Participant

Rayford Wilkins - Group President - Marketing and Sales - SBC Communications Inc.

Oh, gross competitive losses are going down. We do measure that and that's one of the ways we look at our win backs. I don't have the percentages. We only release the net, because that's usually what everybody looks at. But I can tell you, they have dropped substantially.

As we enter into long distance in every one of the space, you can see a precipitous drop immediately in those particular losses. Now, that doesn't mean we still don't have losses, but that's one of the ways we really drive up the win back rates. In other words, we're more effective on the win back and we're losing fewer lines.

Unidentified Participant

Thank you. You mentioned that you expect margin stability by the end of next year. And what I'm curious about is, since there's been compression of, you know, 4% or 5% over those past few quarters, once you get to the end of next year, what lines of your business, then, do you expect might be able to add incremental margins to bring you back up into the upper 30's? Or are we just relegated to seeing mid-30's, low 30's EBITDA margins?

And then second question, with wire line or 100% wire line porting now coming into play, can you give us an idea of how to look at the expense or incremental cost of that and whether that's imbedded in your 2004 expenses as of yet?

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SBC - SBC Communications Analyst Meeting

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

Randall, do you want to try?

Randall Stephenson - CFO - SBC Communications

In terms of the margins, I mean, you've seen the margins gradually work their way down. The objective is to stabilize access line losses. And you saw Ray's chart about what the opportunity is in the Midwest. The one thing that would cause margins to expand would be if you actually started taking lines back. We'll see.

I mean, we'll have to see if we can actually expand, you know, or increase penetration on access lines and cause margins to expand. The new services we're going into -- very specifically the high end business and medium end business -- those are just inherently lower margin business than we've traditionally been in.

The difference is, they're very low capital intensity businesses. So, the lower margins are, you know, actually, I'm good with that. They require less capital, slightly lower margins. That will probably keep margins, you know, at a stable range. Not necessarily expanding as we get into next year, but stabilizing. And it's just lower capital intensity business.

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

I might add to that. We've been hit harder than the other companies on these Uni-P (ph) rates. And we thoroughly believe there's some upward opportunity on those uni-rates (ph) in the next few months because we've had lower rates than any other company. So, we've probably lost more due to that, but we have more opportunity coming back to gain those, right? And have some expansion -- multiple expansion -- margin expansion.

Unidentified Participant

In terms of the wireless LNP impact, I think, Stan, you're spending pretty hot right now trying to basically prepare for wireless number portability. You're not going to see those costs probably come down in Q4, but I'd say they're probably embedded in there for the next couple quarters.

Unidentified Participant

Stan Sigmun - President and CEO - Cingular Wireless

Wire line portability?

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

Wire line to ...

Stan Sigmun - President and CEO - Cingular Wireless

There are no significant incremental costs associated with wire line number portability. I mean, we've been porting numbers on the wire line side for a few years. And it's no inherently different to do it wireless than it is wire line.

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

Right.

Stan Sigmun - President and CEO - Cingular Wireless

Is that your question?

Unidentified Participant

Yes.

Mike Coffee - Managing Director of Investor Relations - SBC Communications Inc.

Mr. Whitacre, we have time for one more question.

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

OK.

Unidentified Participant

I didn't want to steal the last one with a second question, but I guess. Randall, if your revenue trends and margin trends -- it

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SBC - SBC Communications Analyst Meeting

sounds like not just for 2004, but for long term -- is so dependent on access lines, your showing 4% line declines over the past several quarters as has the rest of the industry.

Where do you expect that to trend long term? Can you get that back and flatten it out over time?

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

You saw a chart on that earlier, didn't you? How it's trending back to zero? I know you were watching that! Boy, I sure was. Go ahead, Randall.

Randall Stephenson - CFO - SBC Communications

To me I would not -- I would argue the main driver of revenues going forward is not necessarily access line. It's a big driver, but the main driver over the next couple of years are going to be these business initiatives that you heard Ray talk about today. Those are big revenue opportunities. And those will be the areas that have the biggest lift on revenue -- as well as DSL.

So, you know, access lines. Will they continue to trend down at 4%? I don't think so. A lot of that is economic driven right now and if you get into a vibrant economy, housing starts, et cetera, I do expect access line trends to stabilize to something better than down 4%.

Unidentified Participant

OK.

Edward Whitacre - Chairman and CEO - SBC Communications Inc.

Thank you for coming. We appreciate it. We'll stick around here a little bit if you have more questions. Thanks again.

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ATTACHMENT 2



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May 7, 2004

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S.W., Room TWB-A325
The Portals
Washington, D.C. 20554

Attention: ARMIS

ARMIS Report: FCC Report 43-03, ARMIS Joint Costs Report

Data Year: 2002

Version: Unrestricted

Dear Ms. Dortch:

Pursuant to the Commission's rulings in CC Docket No. 86-182, the following 2002 FCC Report 43-03, ARMIS Joint Costs Reports are being submitted for the SBC West region:

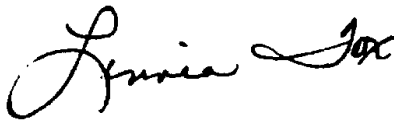
<u>COSA</u>	<u>Submission No.</u>
SWAR	3
SWKS	3
SWMO	3
SWOK	3
SWTX	3

Ms. Marlene H. Dortch
May 7, 2004
Page 2 of 2

SBC is re-submitting its 2002 ARMIS 43-03 report for COSAs SWAR, SWKS, SWMO, SWOK, SWTX to correctly allocate costs of an administrative affiliate of Southwestern Bell Telephone, L. P. Also, revised is Cash Working Capital, accounts and subaccounts not included in Subject to Separations, the correct treatment of account 6561 for separations purposes. Changed in this submission are rows 6110, 6112, 6121, 6123, 6124, 6120, 6510, 6512, 6535, 6530, 6623, 6620, 6561, 6560, 6721, 6723, 6724, 6726, 6728, 6720, 720, 7220, 7250, 7200, 7310, 7320, 7360, 7370, 750, 230, and 370.

Should you have questions regarding this data, please call me on 202 326-8842.

Sincerely,

A handwritten signature in cursive script, appearing to read "Linnia Fox".

Enclosures

Date Run Date: 09/22/2004

FCC Report 43-03, the ARMIS Joint Cost Report
Table I. Regulated/Nonregulated Data

Report Number	COSA	Company	Y2002 Sub Num	Row	Row Title	Y2002 Total (b)
4303	SWAR	Southwestern - Arkansas	3	750	Total Expenses	691,396
4303	SWMO	Southwestern - Missouri	3	750	Total Expenses	1,808,143
4303	SWTX	Southwestern - Texas	3	750	Total Expenses	7,049,380

Footnotes

COSA	Year	Period	Table	Row	Column	Footnote Number	Sequence	Footnote
SWAR	2002	1	I	ALL	ALL	4	1	DURING 2003, THE COMPANY OBSERVED THAT THE METHODOLOGY
SWAR	2002	1	I	ALL	ALL	4	2	USED BY SBC SERVICES, INC., AN ADMINISTRATIVE AFFILIATE
SWAR	2002	1	I	ALL	ALL	4	3	OF SOUTHWESTERN BELL TELEPHONE COMPANY LP (SWBT), TO
SWAR	2002	1	I	ALL	ALL	4	4	ALLOCATE ITS COSTS AMONG BENEFITING AFFILIATES WAS NOT
SWAR	2002	1	I	ALL	ALL	4	5	APPLIED APPROPRIATELY. THE PRIOR METHOD USED RESULTED
SWAR	2002	1	I	ALL	ALL	4	6	IN TOO MUCH COSTS BEING BILLED TO SWBT. IN ADDITION,
SWAR	2002	1	I	ALL	ALL	4	7	IT WAS ALSO DISCOVERED THAT CERTAIN COSTS BILLED FROM
SWAR	2002	1	I	ALL	ALL	4	8	PACIFIC BELL TELEPHONE COMPANY TO SBC SERVICES, INC.
SWAR	2002	1	I	ALL	ALL	4	9	FOR LEASED ASSETS WERE NOT CALCULATED APPROPRIATELY.
SWAR	2002	1	I	ALL	ALL	4	10	THIS ALSO CAUSED AN INCORRECT AMOUNT OF SHARED COSTS
SWAR	2002	1	I	ALL	ALL	4	11	TO BE BILLED TO SWBT. BOTH OF THESE ISSUES REDUCED
SWAR	2002	1	I	ALL	ALL	4	12	EXPENSES (ACCOUNTS 6112, 6121, 6123, 6124, 6512, 6535,
SWAR	2002	1	I	ALL	ALL	4	13	6623, 6721, 6723, 6724, 6726, AND 6728) FOR
SWAR	2002	1	I	ALL	ALL	4	14	SWBT-ARKANSAS BY \$6M, WITH AN ASSOCIATED \$2M
SWAR	2002	1	I	ALL	ALL	4	15	TAX INCREASE (ACCOUNT 7220 AND 7230).
SWMO	2002	1	I	ALL	ALL	4	1	DURING 2003, THE COMPANY OBSERVED THAT THE METHODOLOGY
SWMO	2002	1	I	ALL	ALL	4	2	USED BY SBC SERVICES, INC., AN ADMINISTRATIVE AFFILIATE
SWMO	2002	1	I	ALL	ALL	4	3	OF SOUTHWESTERN BELL TELEPHONE COMPANY LP (SWBT), TO
SWMO	2002	1	I	ALL	ALL	4	4	ALLOCATE ITS COSTS AMONG BENEFITING AFFILIATES WAS NOT
SWMO	2002	1	I	ALL	ALL	4	5	APPLIED APPROPRIATELY. THE PRIOR METHOD USED RESULTED
SWMO	2002	1	I	ALL	ALL	4	6	IN TOO MUCH COSTS BEING BILLED TO SWBT. IN ADDITION,
SWMO	2002	1	I	ALL	ALL	4	7	IT WAS ALSO DISCOVERED THAT CERTAIN COSTS BILLED FROM
SWMO	2002	1	I	ALL	ALL	4	8	PACIFIC BELL TELEPHONE COMPANY TO SBC SERVICES, INC.
SWMO	2002	1	I	ALL	ALL	4	9	FOR LEASED ASSETS WERE NOT CALCULATED APPROPRIATELY.
SWMO	2002	1	I	ALL	ALL	4	10	THIS ALSO CAUSED AN INCORRECT AMOUNT OF SHARED COSTS
SWMO	2002	1	I	ALL	ALL	4	11	TO BE BILLED TO SWBT. BOTH OF THESE ISSUES REDUCED
SWMO	2002	1	I	ALL	ALL	4	12	EXPENSES (ACCOUNTS 6112, 6121, 6123, 6124, 6512, 6535,
SWMO	2002	1	I	ALL	ALL	4	13	6623, 6721, 6723, 6724, 6726, AND 6728) FOR
SWMO	2002	1	I	ALL	ALL	4	14	SWBT-MISSOURI BY \$21M, WITH AN ASSOCIATED \$8M
SWMO	2002	1	I	ALL	ALL	4	15	TAX INCREASE (ACCOUNT 7220 AND 7230).
SWTX	2002	1	I	ALL	ALL	4	1	DURING 2003, THE COMPANY OBSERVED THAT THE METHODOLOGY
SWTX	2002	1	I	ALL	ALL	4	2	USED BY SBC SERVICES, INC., AN ADMINISTRATIVE AFFILIATE
SWTX	2002	1	I	ALL	ALL	4	3	OF SOUTHWESTERN BELL TELEPHONE COMPANY LP (SWBT), TO
SWTX	2002	1	I	ALL	ALL	4	4	ALLOCATE ITS COSTS AMONG BENEFITING AFFILIATES WAS NOT
SWTX	2002	1	I	ALL	ALL	4	5	APPLIED APPROPRIATELY. THE PRIOR METHOD USED RESULTED
SWTX	2002	1	I	ALL	ALL	4	6	IN TOO MUCH COSTS BEING BILLED TO SWBT. IN ADDITION,
SWTX	2002	1	I	ALL	ALL	4	7	IT WAS ALSO DISCOVERED THAT CERTAIN COSTS BILLED FROM
SWTX	2002	1	I	ALL	ALL	4	8	PACIFIC BELL TELEPHONE COMPANY TO SBC SERVICES, INC.
SWTX	2002	1	I	ALL	ALL	4	9	FOR LEASED ASSETS WERE NOT CALCULATED APPROPRIATELY.
SWTX	2002	1	I	ALL	ALL	4	10	THIS ALSO CAUSED AN INCORRECT AMOUNT OF SHARED COSTS
SWTX	2002	1	I	ALL	ALL	4	11	TO BE BILLED TO SWBT. BOTH OF THESE ISSUES REDUCED
SWTX	2002	1	I	ALL	ALL	4	12	EXPENSES (ACCOUNTS 6112, 6121, 6123, 6124, 6512, 6535,
SWTX	2002	1	I	ALL	ALL	4	13	6623, 6721, 6723, 6724, 6726, AND 6728) FOR
SWTX	2002	1	I	ALL	ALL	4	14	SWBT-TEXAS BY \$63M, WITH AN ASSOCIATED \$22M
SWTX	2002	1	I	ALL	ALL	4	15	TAX INCREASE (ACCOUNT 7220).